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IN THE

Supreme Court of the United States

LONNIE GLOVER AND DAWN GLOVER,
AND ALL OTHERS SIMILARLY SITUATED,
Petitioners,

v.

STANDARD FEDERAL BANK, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a class may be certified to challenge a lender's uniform practice of paying premiums to mortgage brokers for directing loans at above-par interest rates to that lender as a violation of the prohibition on referral fees under § 8(a) of the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. § 2607(a), where the premiums are paid pursuant to standard agreements and admittedly bear no relation to any actual services performed by the broker.

2. Whether a court must defer to an agency policy statement that was not issued pursuant to notice-and-comment rulemaking and that lacks the force of law, when that policy statement purports to interpret regulations that simply mirror the statutory text and reverses the longstanding prior position of the agency.

LIST OF PARTIES TO THE PROCEEDINGS BELOW

Lonnie Glover and Dawn Glover, together with all others similarly situated, were plaintiffs and appellees below.

Standard Federal Bank was a defendant and appellant below.

Heartland Mortgage was a defendant below, but did not participate in proceedings in the court of appeals.

ABN AMRO Mortgage Group, Inc., was a defendant below, but did not participate in proceedings in the court of appeals.

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LONNIE GLOVER AND DAWN GLOVER,
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STANDARD FEDERAL BANK, *ET AL.*,
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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-20a) is reported at 283 F.3d 953. The opinions and orders of the district court (Pet. App. 21a-23a, 26a-42a, 43a-52a) are not reported.

JURISDICTION

The judgment of the court of appeals was entered on March 21, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES, REGULATIONS, AND RULES INVOLVED

Pertinent sections of the Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. §§ 2601 *et seq.*, the regulations implementing RESPA, and Federal Rule of Civil Procedure 23 are at Pet. App. 53a-87a.

STATEMENT

More than 750,000 people have obtained mortgage loans from respondent Standard Federal Bank ("Standard Federal") in which their broker received a fee from the bank, not for any identifiable services the broker performed for the bank or the borrower, but simply because the broker directed a loan with an above-market interest rate to Standard Federal.

Such kickbacks and other referral fees are prohibited under the plain terms of § 8(a) of the Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. § 2607(a). But vindicating the rights of individual homeowners is difficult, because the injury suffered is generally between $500 and $2,500 each. Such widespread, small injuries to consumers, which are traceable to a common source and stem from standard referral agreements and form contracts, are ideally suited to resolution through a class action. *See, e.g., Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625 (1997).

The court below, however, in direct conflict with the Eleventh Circuit, has concluded that assessing the legality of such payments requires a case-by-case determination of whether the overall amount of the fees received by the broker is "reasonable" in light of the actual services performed by the broker. In reaching that conclusion, the court deferred to a 2001 policy statement issued by the Department of Housing and Urban Development ("HUD"). This policy statement — which was not the result of notice-and-comment proceedings and does not have the force of law — not only reversed HUD's prior interpretation of RESPA, but was issued for the express purpose of disagreeing with the Eleventh Circuit's decision to certify a class action challenging another lender's practice of paying these so-called "yield spread premiums" to brokers.

In addition to creating a direct conflict with the Eleventh Circuit's decision to certify a class to pursue an identical RESPA claim, the court's decision to defer to

HUD's informal policy statement itself conflicts with a number of circuits on the proper principles to apply in dealing with an informal policy statement that lacks the force of law and is inconsistent with the agency's long-standing prior interpretation of the statute.

1. In 1972, a report by HUD and the Veterans Administration uncovered widespread evidence of abusive practices, kickbacks, and unearned fees in the closing of residential real estate transactions. Department of Housing and Urban Development and Veterans Administration, *Report on Mortgage Settlement Costs* at 3 (Jan. 1972). The report concluded that, as a result of these practices, "[s]ettlement charges often are based on factors unrelated to the cost of providing the services." *Id.*

In 1974, Congress enacted RESPA to redress those problems. Section 8(a) of RESPA provides that "[n]o person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." 12 U.S.C. § 2607(a). As the House Report accompanying RESPA explained, the Act was intended to "prohibit[ ] or regulat[e] abusive practices, such as kickbacks, unearned fees, and unreasonable accounts." H.R. Rep. No. 93-1177, at 4 (1974); *see also* S. Rep. No. 93-866 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6546, 6551 (§ 8(a) "is intended to prohibit all kickback or referral fee arrangements"). Violations of § 8(a) are subject to criminal sanctions and civil penalties. *See* 12 U.S.C. § 2607(d).

The reforms to housing settlement practices ushered in by RESPA became even more critical in light of subsequent trends in the real estate finance industry. Historically, homebuyers obtained their loans directly from a local lender, such as a bank or savings and loan. *See Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to*

Mortgage Brokers, 64 Fed. Reg. 10080, 10080 (1999) ("1999 Policy Statement"), Pet. App. 129a. Beginning in the 1980s, independent mortgage "brokers" began to offer loans, funded by various lenders, directly to homebuyers. *Id.* Today, approximately one-half of all mortgage loans in the United States are originated by mortgage brokers. These brokers also offer certain services to homebuyers, such as assisting the homebuyer in completing the loan application form, arranging for property appraisals and credit reports to be completed, and choosing the lending institution that finances the homebuyer's mortgage. A homebuyer may pay the broker directly for those services or add those fees to the principal balance of the loan, to be subtracted and paid to the broker at closing. A broker may have a relationship with as many as 20 different lenders and therefore has wide discretion in a competitive marketplace to determine which lender will fund the homebuyer's loan. *Id.* at 10080-81, Pet. App. 129a-130a.

The interest rates at which lenders make loans available vary depending on the existing market conditions, the size of the loan, the length of the mortgage, and the length of time between the date the interest rate is locked in and the closing date. Each day, and sometimes several times per day, Standard Federal disseminates a "rate sheet" that sets forth a series of interest rates available for the different loan types offered. The rate sheet also informs brokers of the incentives and bonuses that the lender offers to pay to the broker — which include, among others, a "yield spread premium" — if the broker procures the homebuyer's loan from that particular lender. (The rate sheet used to obtain petitioner Glovers' loan is reproduced at Pet. App. 208a-210a.)

These rate sheets expressly state that they should not be made available to consumers. *See id.* As a consequence of the imperfect information given to homebuyers about interest rates, the broker has an incentive to

offer the homebuyer an interest rate above market and thereby receive the largest possible yield spread premium from the lender.

The yield spread premium and other bonuses that respondent Standard Federal paid to Heartland Mortgage ("Heartland") for petitioner Glovers' loan were calculated as follows, using Standard Federal's rate sheet for September 3, 1996.[1] Although the "par," or market, rate on that day for a 30-year fixed-rate mortgage loan, with a 30-day "lock in" period, was 8.5 percent, Heartland arranged for the Glovers to obtain a $124,000 mortgage loan from Standard Federal at the above-par interest rate of 8.75 percent. The rate sheet indicates that the price for this loan is 101.000, which means that Heartland received from Standard Federal a yield spread premium of 1 percent of the total amount of the loan, or $1,240. Standard Federal's rate sheet also offered an additional bonus payment of 0.25 percent of the loan value for a loan, such as the Glovers', in excess of $100,000. As a result, Heartland received an additional $310, for a total payment of $1,550. This payment was in addition to the compensation Heartland received directly from the Glovers, which included a $1,240 loan origination fee and a $335 processing fee.[2]

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[1] We use the Glovers' loan for illustrative purposes, but every class member experienced similar factual circumstances. An additional example of the calculation of a yield spread premium and other monetary bonuses that Standard Federal paid to a mortgage broker can be found in Howell E. Jackson & Jeremy Berry, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, at 4-5 (Jan. 2002) ("Jackson & Berry"), *available at* http://www.law.harvard.edu/faculty/hjackson/january_draft.pdf. Professor Jackson prepared an expert witness report to the district court in support of petitioners and has since prepared the law review article, cited above, setting forth his findings and conclusions.

[2] The Glovers' federally mandated settlement form ("HUD-1"), like the other class members' forms, discloses that the Glovers' made a direct payment to Heartland for all amounts they owed for services rendered by Heartland. *See* Pet. App. 211a-212a. The $1,550 yield spread premium that Standard Federal paid to Heartland was not

2. On September 12, 1997, petitioners Lonnie and Dawn Glover filed a complaint in the district court for the District of Minnesota on behalf of a nationwide class of persons, alleging, *inter alia*, that respondent Standard Federal violated RESPA § 8(a) by paying referral fees — including yield spread premiums, service release premiums, and other bonuses and "incentive" payments — to mortgage brokers in connection with their home loans. Petitioners argued that class certification was appropriate because, *inter alia*, their claims involved alleged violations of a federal statute based on common issues of law and fact related to respondent's established business practices, as evidenced through standard referral agreements and form contracts between Standard Federal and mortgage brokers, other corporate documents, and the testimony of respondent's managers and agents.

On March 1, 1999, HUD issued a policy statement articulating a test for determining whether a payment by a lender to a mortgage broker violated RESPA § 8(a). *See* 1999 Policy Statement, Pet. App. 126a. HUD's policy statement purported to interpret its existing regulations, as first promulgated in 1976 and as amended in 1992, which largely tracked the language of RESPA. HUD's test has two prongs: (1) whether "services were actually performed for the compensation paid"; and (2) whether "the payments are reasonably related to the value of the . . . services that were actually performed." 64 Fed. Reg. at 10084, Pet. App. 143a-144a.

On August 26, 1999, the district court denied petitioners' request for class certification. *See* Pet. App. 43a-52a. First, the court noted that other courts within its district had held that the 1999 Policy Statement required only that the mortgage broker perform some

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used to offset any fees the Glovers owed for services rendered by Heartland. *See id.* By statute, the HUD-1 form must "conspicuously and clearly itemize all charges imposed upon the borrower." 12 U.S.C. § 2603(a).

services for the borrower and that the broker's total compensation — received from the borrower and the lender — meet a reasonableness standard. *Id.* at 50a-51a. Second, the court concluded that it was required to grant *Chevron* deference to HUD's 1999 Policy Statement. *Id.* at 50a (citing *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-45 (1984)). Therefore, despite being "troubled by this analysis of the requirements of RESPA" — because it caused the first prong of HUD's test to "ring[ ] hollow" and allowed an "explicit[ ] . . . kickback . . . [to] be declared legal" depending on "whether, in the final analysis, the amount of money given to the broker *in toto* happens to be reasonable" — the court adopted the same approach as the other courts within its district. *Id.* at 49a-50a.

On March 22, 2000, in response to petitioners' renewed motion for class certification, the court reconsidered its earlier decision and issued an order granting petitioners' motion and denying respondent's motion for summary judgment. *Id.* at 26a-42a. On reconsideration, the court concluded that the better reading of the 1999 Policy Statement is that HUD had intended to set forth the test argued for by petitioners, under which payments from lenders to brokers are illegal referral fees if not paid "in exchange for" particular services. *Id.* at 35a. The court further held that, even if it were to conclude that the 1999 Policy Statement adopted the "reasonableness of total compensation" test, as held by the other courts in its district, it would "be compelled to conclude that, in fact, such a standard is arbitrary and capricious," "irrational," and not deserving of deference under step two of *Chevron*. *Id.* Finally, the court held that "common questions of law and fact predominate," because "the method for calculating the compensation does not vary from mortgage to mortgage" and the "Defendants themselves note that the rate sheets . . . are not designed to be loan specific." *Id.* at 36a.

The evidence petitioners obtained from respondents and their witnesses in discovery more than amply supports the district court's conclusion.[3] For example, Standard Federal's managers testified that "[t]he purpose of offering any payment is to induce [the broker] to sell [the loan] to us" and that, if a lender is "not competitive" in offering "additional pricing" for the loan, "the broker will send it to somebody who is." *Id.* at 220a, 224a. Indeed, a flyer that Standard Federal sent to brokers in Texas advertised that, for a $100,000 loan referred to respondent, "[y]ou make ($1,125.00) 1.125 points over the rate sheet price! That's more money in YOUR pocket!" *Id.* at 225a. One of respondent's witnesses testified that "[t]he pricing model [for the yield spread premium] doesn't have anything to do with what the broker does or doesn't do," while another stated that he was "not aware of any services" that a mortgage broker "performs in any given transaction" that are "a factor that go[es] into the pricing" of the yield spread premium. *Id.* at 214a, 217a. Yet another of Standard Federal's managers candidly testified that "[w]e don't feel it's our responsibility to understand fully what the broker needs to be compensated on a transaction." *Id.* at 222a.[4]

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[3] Further discovery proceeded in the district court while this interlocutory appeal was pending in the court below. Petitioners moved to supplement the appellate court record with testimony and material obtained during discovery, but the Eighth Circuit denied those motions. *See* Order, *Glover v. Standard Federal Bank*, No. 00-3611 (8th Cir. Nov. 30, 2001).

[4] Although Standard Federal has claimed that yield spread premiums offer borrowers the option of financing a portion of their closing costs through a higher interest rate, its own manager testified that "it's not our specific intent to use [the yield spread premium] to reduce closing costs." Pet. App. 222a. In fact, an analysis of nearly 3,000 loans provided by Standard Federal revealed that brokers received yield spread premiums for 85 to 90 percent of those loans; that more than 75 percent of those borrowers could have increased the amount of their loan in order to finance their closing costs, without agreeing to an above-par interest rate on the entire loan; that

On September 26, 2000, after briefing by the parties, the district court clarified that it had not intended its March 22, 2000 order to limit the certified class to persons obtaining a mortgage financed by Standard Federal and brokered only by Heartland, and modified its order accordingly so that "the Class should be defined without respect to the mortgage broker." Pet. App. 22a. As the court explained, "a class of individuals who obtained a mortgage financed by Standard Federal Bank and brokered by *any* mortgage broker is appropriate, so long as the brokers were party to identical Correspondent Agreements." *Id.* at 22a-23a.

3. Standard Federal sought review of the court's clarification of the class definition under Federal Rule of Civil Procedure 23(f). On November 1, 2000, the Eighth Circuit allowed the interlocutory appeal, and the parties completed their briefs in May 2001. On October 18, 2001, the day before oral argument in this case, HUD published a policy statement purporting to clarify its 1999 Policy Statement. In its 2001 Policy Statement, HUD stated its position that, in assessing whether a payment from a lender to a mortgage broker violates RESPA § 8(a), "it is necessary to look at each transaction individually," and not on a class-wide basis, to determine whether the total compensation received by the broker was reasonable. 66 Fed. Reg. at 53055, Pet. App. 99a. HUD also expressly disagreed with the decision of

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yield spread premium payments are not used, on a dollar-for-dollar basis, to offset borrowers' up-front costs (enabling brokers to earn an average of $1,000 more on loans with yield spread premiums); and that the annual interest rate on this form of "financing" exceeds 100 percent. *See* Jackson & Berry, *supra*, at 122, 127-29, 144-47; *see also* Pet. App. 188a-192a. HUD, which asserted in its 2001 Policy Statement that borrowers use yield spread premiums to finance closing costs, did not confront these facts, even though it was presented with Professor Jackson's analysis. *See Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b)*, 66 Fed. Reg. 53052, 53054 (2001) ("2001 Policy Statement"), Pet. App. 95a-96a.

the Eleventh Circuit in *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001), *cert. denied*, 122 S. Ct. 930 (2002), in which that court, like the district court here, held that a payment by a lender to a mortgage broker that is not in exchange for services violates § 8(a) and, therefore, that class certification is appropriate. *See id.* at 1329-32; 2001 Policy Statement, 66 Fed. Reg. at 53054-55, Pet. App. 98a-99a. In HUD's view, each transaction must be scrutinized individually to determine whether the broker performed services aside from the referral and whether the overall fee earned by the broker (including amounts received from the borrower as well as the lender) was reasonable in light of those services. *Id.* at 53054, Pet. App. 97a-98a. [5]

In reliance on HUD's new policy statement, the Eighth Circuit reversed the district court's certification of the class. Although the Eighth Circuit found that HUD's policy statement does "not warrant *Chevron*-style deference" under this Court's decisions in *United States v. Mead Corp.*, 533 U.S. 218 (2001), and *Christensen v. Harris County*, 529 U.S. 576 (2000), it concluded that the policy statement merited deference under *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945), even though the agency's regulations implementing § 8(a) "simply mirror[]" the statutory language. Pet. App. 11a-13a. Recognizing that its application of *Seminole Rock* deference conflicted with a decision of the Fourth Circuit, the Eighth Circuit also stated that the policy statement had "sufficient power to persuade" under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). Pet. App. 13a.

Adopting HUD's conclusion that proving a violation of § 8(a) requires a case-by-case inquiry, the Eighth Circuit

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[5] Petitioners and respondents each sought leave to file a supplemental brief on the 2001 Policy Statement and the appropriate level of deference, if any, to be given to that statement. The Eighth Circuit denied the requests. *See* Order, *Glover v. Standard Federal Bank*, No. 00-3611 (8th Cir. Nov. 30, 2001).

"reject[ed] the analysis in *Culpepper*" and noted that, "while it remains the law in the Eleventh Circuit, we choose a different conclusion, giving due deference to HUD's interpretations of its regulations." *Id.* at 19a. Accordingly, the Eighth Circuit found class certification "impracticable." *Id.* at 20a.

REASONS FOR GRANTING THE PETITION

The Eighth Circuit's conclusion that a violation of RESPA § 8(a) can be proved only on a loan-by-loan basis conflicts with the plain language of that section, which makes illegal any "agreement or understanding" to pay referral fees or kickbacks. Because petitioners had ample evidence that Standard Federal has entered into such agreements with its affiliated brokers, class certification was appropriate. The Court should grant certiorari to resolve a direct conflict with the Eleventh Circuit on this issue and to ensure that 750,000 homebuyers are not deprived of their day in court.

The Court should also grant certiorari to resolve a deepening conflict on whether deference under *Seminole Rock* or *Skidmore* is warranted when an agency's informal policy statement lacks the force of law and is inconsistent with the agency's longstanding, prior interpretation of the statute. The First, Seventh, and Tenth Circuits have rejected the position adopted by the Eighth, Second, D.C., and Federal Circuits that *Seminole Rock* deference may be applied to informal agency interpretations of regulations after this Court's decisions in *Mead* and *Christensen*. And the D.C. and Fifth Circuits have rejected the Eighth Circuit's alternative position that *Skidmore* may be applied to an agency's attempt to change its interpretation of a regulation without notice-and-comment rulemaking.

I. THE EIGHTH CIRCUIT'S DECERTIFICATION OF A CLASS JOINED TO ENFORCE RESPA § 8(a) AGAINST ILLEGAL YIELD SPREAD PREMIUMS CONFLICTS WITH THE PLAIN LANGUAGE OF THE STATUTE AND A DECISION OF THE ELEVENTH CIRCUIT ON THE IDENTICAL ISSUE

A. Respondents' Practices Of Paying And Receiving Yield Spread Premiums Raise Common Issues Of Fact And Law Under RESPA § 8(a)

Under Federal Rule of Civil Procedure 23(b)(3), a class action may be maintained if the court "finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members." The district court certified a nationwide class of "all people obtaining a mortgage during the appropriate time period, financed by Standard Federal Bank under circumstances which gave rise to yield spread premiums or service release premiums, and brokered by any mortgage broker pursuant to a Correspondent Agreement identical to the Correspondent Agreement between Standard Federal Bank to Heartland Mortgage Corp." Pet. App. 23a.[6] The district court found that whether the yield spread premiums that Standard Federal paid to its affiliated brokers violated § 8(a) could be determined "on a class-wide basis where the method for calculating the compensation does not vary from mortgage to mortgage." *Id.* at 36a.

The court of appeals, however, found that common issues of law and fact did not predominate. The court did not base its analysis on any facts found by the district court or its own analysis of RESPA. Rather, the court rested its judgment solely on deference to HUD's 2001 Policy Statement, in which the agency stated that, "'in

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[6] "Service release premium" is one of a number of other names for a yield spread premium.

order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually.'" *Id.* at 10a (quoting 66 Fed. Reg. at 53055, Pet. App. 99a); *see also id.* at 8a-9a (HUD's policy statement "is dispositive in this case because if we endorse the two-part test advocated by HUD, the inquiry in each case must necessarily be made on a loan-by-loan basis, therefore eliminating class treatment").

1. The court's judgment that petitioners' case may not be certified as a class conflicts with the plain language of RESPA § 8(a), which provides that "[n]o person shall give and no person shall accept any fee, kickback, or thing of value *pursuant to any agreement or understanding*, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." 12 U.S.C. § 2607(a) (emphasis added).

Respondent Standard Federal's practice of paying yield spread premiums falls squarely within the ambit of § 8(a). Under the contractual arrangements between Standard Federal and its affiliated brokers, Standard Federal published on a rate sheet the premiums and bonuses it would pay if a broker (such as Heartland) directed a mortgage loan to Standard Federal. Pursuant to the rate sheet and the other terms and conditions of that business relationship, the size of that premium was not dependent on any particular services provided by the broker, but rather varied in relation to the "par" interest rate and the size of the loan. Moreover, Standard Federal's managers admitted in depositions that respondent pays yield spread premiums to induce mortgage brokers to refer loans to Standard Federal, as opposed to one of its competitors. *See* p. 8, *supra*. As such, Standard Federal's yield spread premium was a "thing of value" provided "pursuant to an[ ] agreement" that

business would be referred.[7] Those facts state a claim for a § 8(a) violation that clearly can be proved on a class-wide basis because the relevant contractual terms and conditions between Standard Federal and its brokers do not vary from loan to loan. *See id.*

2. Standard Federal's yield spread premiums are not shielded from liability under RESPA § 8(c), which provides that "[n]othing in this section shall be construed as prohibiting . . . the payment to any person of . . . compensation . . . for services actually performed." 12 U.S.C. § 2607(c)(2). The court below accepted the erroneous notion that some referral fees may be legal under § 8(c) if, in addition to those fees, a broker receives other payments from the borrower in exchange for actual services and the overall compensation received by the broker is reasonable. That position cannot be squared with the plain language of § 8(c), which expressly states that compensation must be "for" the services performed, not that such payments must merely be "reasonably related" to those services, as HUD and the court below erroneously construed. 2001 Policy Statement, 66 Fed. Reg. at 53055, Pet. App. 99a; *see id.* at 17a. Moreover, respondent's managers have admitted that the yield spread premiums Standard Federal paid were not for services performed and, in fact, that it did not know what services brokers did perform in any given transaction. *See* p. 8, *supra*. Section 8(a)'s explicit prohibition on referral fees would be rendered completely null if a lender could pay an explicit referral fee as long as the broker also received additional compensation in ex-

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[7] A lender could legally pay a yield spread premium if, unlike Standard Federal, it entered into agreements that required brokers to inform borrowers of the option of financing some or all of their closing costs by accepting an above-par interest rate and if it took steps to ensure that brokers actually used the entirety of the yield spread premium to offset the closing costs that the borrower owed to the broker. *See* note 4, *supra*.

change for services and the broker's total compensation, including the kickback, was a "reasonable" amount.

3. Not only does the decision of the court below conflict with the plain meaning of § 8(a), but it also "is invalid because it alters the [RESPA] cause of action in a fundamental way." *Ragsdale v. Wolverine World Wide, Inc.*, 122 S. Ct. 1155, 1162 (2002). Congress established a private right of action to remedy violations of RESPA's categorical prohibition on "any agreement or understanding" to pay kickbacks or referral fees. 12 U.S.C. § 2607(a), (d)(2), (d)(5). Deferring to HUD's 2001 Policy Statement, the court below altered that remedial scheme in a manner that "instructs the courts to ignore [RESPA's] command." *Ragsdale*, 122 S. Ct. at 1163; *see also id.* at 1160-61 (refusing to defer to agency's interpretation). Given the uniform practices followed by Standard Federal, as embodied in substantively identical contracts with all of its affiliated brokers, the court below defied common sense in ruling that a violation of § 8(a) requires a "loan-specific analysis . . . to determine civil liability." Pet. App. 19a.[8]

B. The Judgment Below Conflicts With Eleventh Circuit Precedent

The court below expressly acknowledged that its judgment conflicts with the Eleventh Circuit's decision in *Culpepper*: "[w]e reject the analysis in *Culpepper*, and while it remains the law in the Eleventh Circuit, we choose a different conclusion, giving due deference to HUD's interpretations of its regulations." Pet. App. 19a.

1. In *Culpepper*, the Eleventh Circuit expressly rejected an identical argument made by a lender and broker in an effort to decertify a class challenging the practice of paying yield spread premiums as referral fees for mortgage loans. On a basis squarely in conflict with the

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[8] Notably, HUD's regulations state that the existence of a prohibited "agreement or understanding" can be "established by a practice, pattern or course of conduct." 24 C.F.R. § 3500.14(e).

Eighth Circuit's decision below, the *Culpepper* court held that certification of a class was appropriate to challenge the legality of yield spread premiums paid by a lender to a broker. As the Eleventh Circuit there explained, "[a] payment is prohibited if '(1) a payment of a thing of value is (2) made pursuant to an agreement to refer settlement business and (3) a referral actually occurs.' *Culpepper I*, 132 F.3d at 696. The undisputed facts in this action are that [the lender] offered to pay (and did pay) a yield spread premium to the broker here, under their agreement, which led the broker to choose [that lender]." 253 F.3d at 1326-27.

In reaching that conclusion, the Eleventh Circuit found unpersuasive the defendant lender's interpretation of HUD's 1999 Policy Statement, which it regarded as "ambiguous" on the "core of the class-certification dispute here" — *i.e.*, "[w]hether transaction-specific evidence is necessary or relevant" in formulating "the rule of liability." *Id.* at 1327-28. The court concluded that "[t]he crux of § 8(a)'s liability test, even when the suspected referral fee is dressed up as something else, is whether the payment is to compensate a referrer for referrals; the answer to that question lies in the terms of the agreement between the referrer and the recipient of the referral." *Id.* at 1330. In the Eleventh Circuit's view, "[u]nder § 8(a), a payment whose reason is to compensate for referrals is illegal, period." *Id.* Because the terms of the payments were set forth in standard referral agreements and form contracts, an individual loan-by-loan analysis was completely unnecessary.

The Eleventh Circuit further rejected any reading of HUD's 1999 Policy Statement that would "deem[] *some* such referral fees legal — that is, referral fees that are paid by lenders and that would be reasonable service fees, if that's what they were." *Id.* The court did not hold that yield spread premiums were "illegal *per se*," but rather that "[t]he core theory of the plaintiffs in this case is that [the lender's] yield spread premiums are re-

ferral fees. . . . Because the plaintiffs could thus prevail solely by showing that [the lender's] yield spread premiums are referral fees, and not service fees, class treatment under Fed.R.Civ.P. 23(b)(3) is appropriate unless that threshold question itself demands loan-by-loan evidence." *Id.* at 1331.

The Eleventh Circuit then rejected the lender's argument that the reason behind the payment of the yield spread premium had to be decided on a loan-by-loan basis. *Id.* at 1331-32. Rather, the court adopted as "the sounder rule" that "the terms and conditions under which a lender pays the broker a yield spread premium can determine whether the yield spread premium is compensation for referring loans rather than a bona fide fee for services." *Id.* at 1332. That conclusion was reinforced by the fact that "[t]here is no suggestion from the evidence or the argument here that [the lender] negotiates yield spread premiums loan-by-loan, rather than paying them according to terms and conditions common to all the loans. Nor does [the lender] contend that it intends some yield spread premiums to pay for services and others to pay for referrals." *Id.* The Eleventh Circuit accordingly affirmed that "common questions of law and fact predominate and that class certification is thus appropriate under Fed.R.Civ.P. 23(b)(3)." *Id.*

Finally, the Eleventh Circuit's analysis of § 8(c) conflicts with the Eighth Circuit's construction of that provision. The Eleventh Circuit found that the plain language of § 8(c) "implies very strongly that only payments whose reason is compensation for services fall within § 8(c)'s safe harbor." *Id.* at 1330. That court further found that "[e]verything about § 8(c) suggests that it is an interpretive gloss on § 8(a) rather than a list of exemptions bestowed upon otherwise illegal conduct" and, therefore, that "we should avoid reading § 8(c) to bless conduct that § 8(a) plainly outlaws." *Id.* Accordingly, the Eleventh Circuit found that § 8(c) posed no bar to class certification in light of its findings that

"[n]othing in [the agreement between the lender and broker] . . . suggests that the amount paid is in any way dependent on the services provided" and that "nothing in the record suggests that the broker renders less service in originating a below-par loan than it does for an above-par loan, or that [the lender] ever inquires into how much work the broker actually did." *Id.* at 1327, 1332.

2. Because the Eleventh Circuit squarely rejected the statutory interpretation HUD has now embraced, there is no basis for thinking that court would reach a different result in a subsequent case in light of HUD's 2001 Policy Statement. *First*, the Eleventh Circuit based its analysis on the plain language of §§ 8(a) and 8(c) and on the *reasons* a lender pays a yield spread premium to a broker. Because the agreement to make such a payment is embodied in standard terms and conditions in contracts between lenders and brokers, the Eleventh Circuit found no merit to the lender's suggestion that such terms needed to be assessed on a loan-by-loan basis. *See Culpepper*, 253 F.3d at 1330. HUD's subsequent adoption of a construction of RESPA §§ 8(a) and 8(c) that the Eleventh Circuit found contrary to the plain language of the statute, therefore, provides no basis for the Eleventh Circuit to reconsider its interpretation of those provisions to permit class certification on facts identical to the ones presented in this case. *See also Mayburg v. Secretary of Health & Human Servs.*, 740 F.2d 100, 106 (1st Cir. 1984) (Breyer, J.) (under *Skidmore*, the "simple fact that the agency *has* a position, in and of itself, is of only marginal significance").

Nor, indeed, is the Eleventh Circuit alone in construing § 8(a), which is enforceable through criminal sanctions and civil penalties, to require analysis of the *reasons* for a payment. Two other courts have rejected the notion (upon which the Eighth Circuit relied) that § 8(c) exonerates referral fees if they are a subset of the payments made by lenders to brokers, the broker actually

performs certain services in closing the transaction (even if those services are unrelated to the reason for the payment of the referral fee), and the overall fee is "reasonable." *See Lawyers Title Ins. Co. v. Dearborn Title Corp.*, 118 F.3d 1157, 1162 (7th Cir. 1997) (holding that § 8(a) liability rests on the *reason* for the rent payment, and not whether total rent was reasonable); *Aiea Lani Corp. v. Hawaii Escrow & Title, Inc.*, 64 Haw. 638, 645, 647 P.2d 257, 262 (1982) (assessing whether reduced title premium was referral fee, and not whether premium was otherwise reasonable).

Second, HUD offered no analysis for its changed position that would cause the Eleventh Circuit to reconsider *Culpepper*. Although HUD "disagrees with the judicial interpretation regarding Section 8 of RESPA and the 1999 Statement of Policy" made by the *Culpepper* court, 2001 Policy Statement, 66 Fed. Reg. at 53054-55, Pet. App. 99a, it never responds to the problem identified by the Eleventh Circuit: that HUD's interpretation would deem legal an express referral payment, or kickback, if it turned out that the sum of the kickback and the compensation the broker received from the borrower was a "reasonable" amount. *See Culpepper*, 253 F.3d at 1330-31. Therefore, although HUD takes the *Culpepper* court to task for not assessing the reasonableness of the fee paid by the lender to the broker, *see* 66 Fed. Reg. at 53055, Pet. App. 99a-100a, that court, like the district court here, plainly held that to do so would turn RESPA on its head: "Under § 8(a), a payment *whose reason* is to compensate for referrals is illegal, period." *Culpepper*, 253 F.3d at 1330 (emphasis added); *see* Pet. App. 35a-36a.

Nor did the Eleventh Circuit, as HUD contended, rely solely on the rate sheet in *Culpepper*. *See* 66 Fed. Reg. at 53055, Pet. App. 99a-100a. Instead, based upon evidence showing that the lender paid yield spread premiums "according to terms and conditions common to all the loans" and that the lender did not "contend that it

intends some yield spread premiums to pay for services," the Eleventh Circuit found that the lender's practices raised common issues of fact and law that made class certification appropriate. *Culpepper*, 253 F.3d at 1332. HUD's 2001 Policy Statement offers no explanation grounded in the text of § 8(a) — which explicitly makes illegal any "agreement or understanding" to pay referral fees — to think otherwise. The evidence adduced in this case establishes that Standard Federal's common practices are susceptible to the same type of class treatment as the lender's practices in *Culpepper*. *See* p. 8, *supra*.

II. HUD'S 2001 POLICY STATEMENT IS NOT ENTITLED TO *SEMINOLE ROCK* DEFERENCE OR *SKIDMORE* CONSIDERATION

Because the plain language of RESPA permits a class to be certified upon a showing of common issues of fact with respect to a lender's uniform practices, the Eighth Circuit had no basis even for entertaining the question whether any deference was due to HUD's policy statement. The court's decision to afford deference to HUD's 2001 Policy Statement, however, independently raises a separate question warranting this Court's review: whether it is appropriate to defer to an agency's policy statement that is not issued pursuant to notice-and-comment rulemaking and that lacks the force of law, particularly when that informal interpretation conflicts with the agency's own longstanding interpretation of the statute. The Eighth Circuit's holding is wrong under this Court's precedents and conflicts with the decisions of other courts of appeals.

A. The Eighth Circuit's Holding That An Agency's Informal Policy Statement Warrants *Seminole Rock* Deference Deepens A Conflict Among Seven Circuits

Although the court below found that HUD's 2001 Policy Statement is an interpretive rule that lacks the force of law and therefore "'do[es] not warrant *Chevron*-style

deference,'" it nonetheless held that HUD's statement deserved *Seminole Rock* deference as an interpretation of HUD's regulations implementing § 8(a). *See* Pet. App. 12a (quoting *Christensen*, 529 U.S. at 587). The court erred in drawing that distinction between agency interpretations of statutes and regulations. When an agency issues an interpretation that lacks the force of law, such as the policy statement at issue here,[9] that interpretation is entitled to no more than *Skidmore* consideration, regardless of whether the agency is interpreting a statute or a regulation. The court's contrary holding is inconsistent with the principles underlying *Mead* and *Christensen* and deepens a conflict among seven courts of appeals.

1. The Eighth Circuit's conclusion that an informal policy statement lacking the force of law is entitled to deference has been rejected by this Court. In *Mead* and *Christensen*, this Court held that the heightened deference afforded by *Chevron* applies only when it is "apparent . . . that Congress would expect the agency to be able to speak with the force of law when it addresses ambiguity in the statute," such as when an agency issues an interpretation through notice-and-comment rulemaking or formal adjudication. *Mead*, 533 U.S. at 229; *see*

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[9] HUD policy statements are not promulgated after notice and comment and do not bind the public or the agency. HUD's regulations also state that such policy statements may be amended or revoked at any time, simply by publication of a subsequent statement in the Federal Register. *See* 24 C.F.R. § 3500.4(a)(1)(ii). Although RESPA § 19(a) authorizes HUD "to make such interpretations . . . as may be necessary to achieve the purposes of this chapter," 12 U.S.C. § 2617(a), that authority is no different from the Treasury Secretary's authority to "'establish[] procedures for the issuance of binding rulings,'" which the *Mead* Court found insufficient to demonstrate that Congress delegated the authority to issue informal rulings that have the force of law. 533 U.S. at 231-33 (quoting 19 U.S.C. § 1502(a)). Indeed, the Government has conceded that interpretations issued pursuant to § 19(a) are "not binding." *United States v. Graham Mortgage Corp.*, 740 F.2d 414, 421-22 (6th Cir. 1984).

Christensen, 529 U.S. at 587. That same reasoning applies to *Seminole Rock* deference, which is based upon a similar congressional delegation of authority and is substantively indistinguishable from *Chevron* deference. *Mead*, 533 U.S. at 227 (*Chevron* deference entails review under 5 U.S.C § 706(2)(A)); *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 377 (1998) ("[s]ubstantive review of an agency's interpretation of its regulations is governed" by 5 U.S.C. § 706(2)(A)); *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 696-98 (1991).[10]

Furthermore, both *Mead* and *Christensen* relied on *Martin v. Occupational Safety & Health Review Commission*, 499 U.S. 144, 157 (1991), which addresses the level of deference due to an agency's interpretation of its regulations and concludes that such an agency interpretation must be imbued with the force of law if it is to be entitled to deference under *Seminole Rock*. *See Christensen*, 529 U.S. at 587; *Mead*, 533 U.S. at 235. In *Martin*, this Court deferred to an agency interpretation of a regulation because it appeared in "a form expressly provided for by Congress" and carried the force of law. 499 U.S. at 157. The Court further stated that, when the Secretary "employs less formal means of interpreting regulations," including "the promulgation of interpretive rules," those interpretations are "not entitled to the same deference as norms that derive from the [agency's] delegated lawmaking powers." *Id.* Thus, shortly after *Christensen*, this Court granted only "some weight" to the Department of Transportation's interpretation of its regulation set forth in an *amicus* brief, and the dissenters agreed that the agency's informal interpretation did

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[10] *See* Thomas W. Merrill & Kristen E. Hickman, *Chevron's Domain*, 89 Geo. L.J. 833, 900 (2001); *see also* Robert A. Anthony, *The Supreme Court and the APA*, 10 Admin. L.J. Am. U. 1 (1996) (arguing that *Seminole Rock* should apply only to agency interpretations that have the force of law); John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 Colum. L. Rev. 612 (1996) (agency interpretations of regulations should receive no more than *Skidmore* consideration).

not warrant *Chevron*-style deference. *Geier v. American Honda Motor Co.*, 529 U.S. 861, 883 (2000); *id.* at 911 (Stevens, J., dissenting) (citing *Christensen*).

The foregoing rule, that an agency's regulatory interpretations lacking the force of law do not receive *Seminole Rock* deference, is grounded in the practical concern that affording deference in that context would give little incentive to agencies to resolve statutory ambiguities by promulgating notice-and-comment regulations.[11] The concern is heightened here, where "the language of the Section 8(a) regulation issued by HUD simply mirrors that of the statute" and, therefore, merely replicates any statutory ambiguity. Pet. App. 11a & n.6; *accord Culpepper*, 253 F.3d at 1327 n.10; *see also Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 110 (1995) (O'Connor, J., dissenting) (agency's failure to address in notice-and-comment rulemaking a "situation [that] *was* foreseen" deprived "the public [of] a valuable opportunity to comment on the regulation's wisdom and those adversely affected the chance to challenge the ultimate rule in court"); *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 525 (1994) (Thomas, J., dissenting) (agency, by "merely replac[ing] statutory ambiguity with regulatory ambiguity," had not fulfilled the "very purpose behind the delegation of lawmaking power to administrative agencies, which is to 'resol[ve] . . . ambiguity in a statutory text'") (quoting *Pauley*, 501 U.S. at 696). On this point, the Eighth Circuit appeared to recognize that its holding conflicted with *Cunningham v. Scibana*, 259 F.3d 303 (4th Cir. 2001), *cert. denied*, 122 S. Ct. 1185 (2002), which refused to grant *Seminole Rock* deference to an informal interpretation of a regulation, where the agency "'simply repeated the statutory language in the regulation and left its interpretation . . . to a program statement.'" *See* Pet. App. 13a (quoting *Cunningham*, 259 F.3d at 307 n.1).

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[11] *See* Anthony, 10 Admin. L.J. Am. U. at 12; Manning, 96 Colum. L. Rev. at 655-56.

Indeed, the attempt to evade the requirements of *Mead* and *Christensen* is particularly evident here, because HUD had previously concluded that notice-and-comment procedures were required to develop a test that would distinguish, based only on the "total compensation" a broker received, "between those fees that are acceptable under section 8 of RESPA and those that are not." *Real Estate Settlement Procedures Act (RESPA) Disclosure of Fees Paid to Mortgage Brokers; Proposed Rule and Notice of Proposed Information Collection Requirements*, 62 Fed. Reg. 53912, 53913 (1997). In that Notice, HUD explained that "[a] major purpose of soliciting public comments . . . is to assist HUD in developing this test." *Id.* However, HUD never promulgated the regulations contemplated by its Notice. Instead, in its 2001 Policy Statement, HUD simply announced the very test that it had previously attempted to establish through notice-and-comment procedures and to "incorporate[] in [a] final rule." *Id.* at 53921. Granting *Seminole Rock* deference to this informal pronouncement, therefore, would "permit the agency, under the guise of interpreting a regulation, to create *de facto* a new regulation." *Christensen*, 529 U.S. at 588. Deference would also enable HUD to override the Eleventh Circuit's interpretation of both § 8(a) and HUD's 1999 Policy Statement — and to divest class members of a judicial remedy provided by the Federal Rules of Civil Procedure — without engaging in notice-and-comment rulemaking to amend its regulations.

2. Not only is the Eighth Circuit's holding affording *Seminole Rock* deference to an informal agency pronouncement lacking the force of law contrary to this Court's decisions in *Mead* and *Christensen*, but it also deepens existing circuit conflicts on two points critical to the sound development of administrative law. First, three circuits have squarely rejected the position taken by the Eighth Circuit that deference may be afforded to an informal agency interpretation that would overturn a court of appeals' prior interpretation of a statute; in-

stead, those courts have held that such deference is warranted only when the agency's interpretation has the force of law. *See Echevarria v. Chicago Title & Trust Co.*, 256 F.3d 623, 630 (7th Cir. 2001) ("Absent a formal commitment by HUD to an opposing position, we decline to overrule our established RESPA § 8(b) case law."); *Satellite Broad. & Communications Ass'n of Am. v. Oman*, 17 F.3d 344, 346-48 (11th Cir.) (deferring, under *Chevron*, to agency interpretation contained in legislative rule, despite having found that same interpretation unpersuasive when issued informally), *cert. denied*, 513 U.S. 823 (1994); *Schisler v. Sullivan*, 3 F.3d 563, 568-69 (2d Cir. 1993) (same); *see also Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735, 740-41 (1996) (granting *Chevron* deference to "a full-dress regulation" adopted in response to litigation).[12]

Second, the court's decision also conflicts with the decisions of three courts of appeals holding that, after *Mead* and *Christensen*, an agency's informal interpretation of a regulation is not entitled to *Seminole Rock* deference and receives, at most, *Skidmore* consideration. *See U.S. Freightways Corp. v. Commissioner of Internal Revenue*, 270 F.3d 1137, 1141-42 (7th Cir. 2001) (citing *Mead*); *Tate v. Farmland Indus., Inc.*, 268 F.3d 989, 993-95 (10th Cir. 2001) (citing *Mead*); *Navarro v. Pfizer Corp.*, 261 F.3d 90, 98-99 (1st Cir. 2001) (citing *Mead* and *Christensen*); *Echevarria*, 256 F.3d at 629 (citing *Christensen*). Indeed, the Seventh Circuit has noted that, if it were to grant *Seminole Rock* deference to an agency's informal interpretation of its regulations, "agencies could pass broad or vague regulations through notice-and-comment procedures, and then proceed to create rules through *ad hoc* interpretations that were subject only to limited judicial review." *U.S. Freight-*

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[12] Even if HUD's 2001 Policy Statement had been promulgated after notice and comment, however, it would not deserve *Chevron* deference, as it cannot be squared with the plain meaning of the statute and, in any event, is unreasonable. *See* pp. 7-8, 12-20, *supra*.

ways, 270 F.3d at 1142. Three other courts of appeals, however, have continued to grant *Seminole Rock* deference to informal agency interpretations of regulations, despite *Christensen* and *Mead*. *See American Express Co. v. United States*, 262 F.3d 1376, 1382-83 (Fed. Cir. 2001); *Esden v. Bank of Boston*, 229 F.3d 154, 169 (2d Cir. 2000), *cert. dismissed*, 531 U.S. 1061 (2001); *Bigelow v. Department of Defense*, 217 F.3d 875, 878 (D.C. Cir. 2000), *cert. denied*, 532 U.S. 971 (2001).

This case presents an ideal vehicle for this Court to resolve those conflicts. First, the court below was fully aware of *Mead* and *Christensen* but afforded *Seminole Rock* deference anyway. *See* Pet. App. 11a-13a. Second, the regulatory history behind HUD's 2001 Policy Statement is quite clear. The agency previously had attempted to promulgate the same rule formally but subsequently sought to accomplish that result through informal means. Third, the Eighth Circuit's decision to afford deference has enormous practical consequences, because the agency decision has the effect of divesting more than 750,000 ordinary citizens of the right to join together, by means of class actions, in order to vindicate Congress's aims in enacting RESPA: to eliminate illegal referrals and kickbacks and thereby to bring down the settlement costs of real estate transactions.

B. The Eighth Circuit's Alternative Holding That HUD's 2001 Policy Statement Deserves *Skidmore* Consideration Is Incorrect And Is Based On A Rule That Conflicts With The D.C. And Fifth Circuits

The court's alternative basis for its decision — that it would adopt the test set forth in HUD's 2001 Policy Statement even if it reviewed that statement under *Skidmore* — appears in a single sentence in the decision: "HUD's Policy Statements in this instance pack sufficient power to persuade given HUD's specialized mission, experience and broad investigation into the consumer lending market." Pet. App. 13a. The court's

failure to assess HUD's interpretation in light of the various *Skidmore* factors[13] — in particular, its failure to address the consistency of the agency's interpretation, *see Mead*, 533 U.S. at 228 & n.8 — conflicts with the decisions of this Court and of other courts of appeals.

1. Although the consistency of an agency's interpretation with earlier pronouncements is of "paramount importance" under *Skidmore*, the court below ignored that factor completely. *Graham*, 740 F.2d at 422; *see EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 257-58 (1991); *General Elec. Co. v. Gilbert*, 429 U.S. 125, 142 (1976); *Barnett v. Weinberger*, 818 F.2d 953, 960-61 & n.74 (D.C. Cir. 1987) (collecting cases). Under a proper analysis, it would have discovered that HUD's current interpretation is flatly inconsistent with the long line of unwavering administrative interpretations issued since the enactment of RESPA, that a case-by-case determination of the reasonableness of the total compensation received by a broker is not required to find a violation of RESPA § 8(a).

HUD's initial regulations implementing § 8(a) provided that a payment "pursuant to an agreement or understanding that settlement will be referred is a violation of Section 8," but that a payment "that bears a reasonable relationship to the value of the goods or services *received by the person or company making the payment* is not prohibited by RESPA section 8." *Part 3500 — Real Estate Settlement Procedures Act*, 41 Fed. Reg. 22702, 22703, 22707 (1976) (emphasis added). Similarly, in a 1996 policy statement, HUD explained that, if a rental payment "is conditioned on the number or value of the referrals made, then HUD will consider

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[13] In *Skidmore*, Justice Jackson explained: "The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." 323 U.S. at 140; *see Mead*, 533 U.S. at 228; *Christensen*, 529 U.S. at 587.

the rental payment to be for the referral of business in violation of Section 8(a)." *Real Estate Settlement Procedures Act (RESPA); Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation*, 61 Fed. Reg. 29264, 29266 (1996), Pet. App. 163a.

Consistent with that interpretation, HUD's 1999 Policy Statement provided that, "[i]n determining whether a payment from a lender to a mortgage broker" violates § 8(a), the first question is "whether goods or facilities were actually furnished or services were actually performed for the compensation paid" by the lender. 64 Fed. Reg. at 10084, Pet. App. 143a. In letters responding to inquiries from members of Congress, HUD's General Counsel confirmed that "goods or facilities must have been furnished or services must have been performed 'for' — i.e., in exchange for — the compensation paid to the broker." Pet. App. 124a; *id.* ("[T]he mere performance of any service by a mortgage broker is not in itself sufficient to establish that the payment to the broker was made in exchange for those services."); *accord id.* at 118a, 121a. And, in a suit brought to enforce § 8(a), HUD required a mortgage lender to fund loans only when "the compensation to the mortgage broker is made in exchange for services actually performed . . . by the broker." Settlement Agreement and Order, *United States v. Delta Funding Corp.*, No. CV-00-1872, at 5 (E.D.N.Y. Mar. 30, 2000) (stating that such rule is "consistent with HUD's Statement of Policy 1999-1"), Pet. App. 170a. Thus, HUD's interpretation of § 8(a) from the enactment of RESPA until the 2001 Policy Statement was that a payment made in exchange for services may not violate § 8(a), but that a case-by-case inquiry into the reasonableness of the compensation was unnecessary if the payment was made pursuant to a referral agreement.

The 2001 Policy Statement is directly contrary to that long-held position. Under HUD's new interpretation, it is now irrelevant whether a lender pays a fee to a broker

pursuant to an agreement to refer business in exchange for the payment. Instead, as long as the broker performs some services that are compensable under HUD's rules, the only question is whether the total compensation received by the broker is reasonable even when a substantial portion of those fees was solely for the referral of business. *See* 2001 Policy Statement, 66 Fed. Reg. at 53055, Pet. App. 99a-101a. Moreover, HUD's current claim that "it is necessary to look at each transaction individually," *id.* at 99a, is inconsistent with its earlier recognition that there are classes of cases, such as those where referrals are made pursuant to an agreement or understanding, that violate § 8(a).[14]

2. Because the 2001 Policy Statement changes HUD's interpretation of its regulations implementing § 8(a), the court's conclusion that the interpretation is entitled to *Skidmore* consideration also conflicts with decisions of the D.C. and Fifth Circuits. Those courts have held that an agency's attempt to change its "authoritative . . . interpretation" of a regulation "without notice and comment" is "invalid." *Alaska Prof'l Hunters Ass'n v. FAA*, 177 F.3d 1030, 1035-36 (D.C. Cir. 1999); *see Monmouth Med. Ctr. v. Thompson*, 257 F.3d 807, 814-15 (D.C. Cir. 2001); *Shell Offshore Inc. v. Babbitt*, 238 F.3d 622, 628-30 (5th Cir. 2001); *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1028 (D.C. Cir. 2000). As the D.C. Circuit has explained, because the Administrative Procedure Act's ("APA") notice-and-comment requirement applies to the promulgation, repeal, and amendment of regulations, "[t]o allow an agency to make a fundamental change in its interpretation of a substantive regulation without notice and comment obviously would undermine those APA requirements." *Paralyzed Veterans of Am. v. D.C. Arena, L.P.*, 117 F.3d 579, 586 (D.C. Cir.

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[14] For the reasons discussed at pages 7-8, 12-20, *supra*, HUD's 2001 Policy Statement is not persuasive under the other *Skidmore* factors — its reasoning is not valid and little thoroughness is evident in its consideration of yield spread premiums. *See* 323 U.S. at 140.

1997), *cert. denied*, 523 U.S. 1003 (1998); *see Geier*, 529 U.S. at 912 (Stevens, J., dissenting) (noting "APA's requirement of new rulemaking when an agency substantially modifies its interpretation of a regulation"); *cf. Guernsey Mem'l*, 514 U.S. at 100 ("APA rulemaking . . . required" where interpretation "adopt[s] a new position inconsistent with . . . existing regulations").

Accordingly, an agency does not have "the same latitude to modify its interpretation of a regulation as it does its interpretation of a statute under *Chevron*." *Paralyzed Veterans*, 117 F.3d at 586. The 2001 Policy Statement therefore is equivalent to so-called post-enactment legislative history and entitled to no consideration at all. *See Pierce v. Underwood*, 487 U.S. 552, 566-67 (1988).

CONCLUSION

The Eighth Circuit's holding in this case directly conflicts with the plain language of RESPA, the admitted facts adduced in discovery, and a judgment of the Eleventh Circuit. The court's decision to afford deference to HUD's 2001 Policy Statement is particularly indefensible, because HUD offered no statutory or factual analysis for engaging in a complete about-face from its prior administrative interpretation of RESPA, and it used its informal administrative authority in an attempt to divest ordinary citizens of their right to bring a class action to vindicate Congress's aim of bringing down settlement costs in residential real estate transactions. A decision by this Court therefore can also give much-needed guidance on important principles of administrative law that have deeply divided seven different circuits. The petition for a writ of certiorari should be granted.

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 00-3611

LONNIE GLOVER AND DAWN GLOVER,
Plaintiffs/Appellees,

v.

STANDARD FEDERAL BANK,
Defendant/Appellant,

AND

HEARTLAND MORTGAGE,
Defendant.

On Appeal from the United States District Court
for the District of Minnesota

Submitted: October 19, 2001

Decided: March 21, 2002

Before McMILLIAN, BEAM, and MURPHY, Circuit Judges.

OPINION

BEAM, Circuit Judge:

The district court issued its first class certification in this matter on March 22, 2000, certifying a class defined as all people obtaining a mortgage brokered by Heartland Mortgage ("Heartland") and financed by Standard Federal Bank ("Standard Federal"). On September 26, 2000, the district court modified its class certification to create a nationwide class defined as all individuals who obtained a mortgage financed by Standard Federal and

brokered by any mortgage broker. This nationwide class certification, encompassing potentially hundreds or thousands of loans, is the subject of this interlocutory appeal. Standard Federal appeals from the district court order confirming class certification. For the reasons set forth below, we reverse.[1]

I. BACKGROUND

Named plaintiffs Lonnie and Dawn Glover acquired an adjustable rate mortgage for the purchase of their home in the late 1980s. In 1996, they refinanced their loan and obtained a fixed-rate mortgage. Heartland brokered the 1996 transaction and Standard Federal funded and acquired the 1996 mortgage.

As part of the 1996 refinancing, Heartland brokered a mortgage for the Glovers with an "above par" interest rate and was subsequently paid a yield spread premium ("YSP") by Standard Federal.[2] The payment of this YSP is the focus of the current dispute.

The Glovers argue that the payment of the YSP constitutes a fee for the referral of a mortgage negotiated with interest rates that are disadvantageous to borrowers, and that this payment violates the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2601, *et. seq.* RESPA was enacted to initiate significant reforms in the real estate settlement process "to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices." 12 U.S.C.

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[1] We also note that a motion of Lonnie and Dawn Glover to strike the affidavit of Margaret K. Savage was taken with the case. The motion is granted.

[2] The disputed payment in the instant case is actually referred to as a "service release premium" in the required Department of Housing and Urban Development disclosures form.

§ 2601(a). RESPA prohibits the payment of some referral fees, stating:

> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

12 U.S.C. § 2607(a) ("Section 8"). Subsection (c) of section 2607 then qualifies subsection (a) by stating:

> Nothing in this section shall be construed as prohibiting (1) the payment of a fee . . . (C) by a lender to its duly appointed agent for services actually performed in the making of a loan, [or] (2) the payment to any person of . . . compensation or other payment for goods or facilities actually furnished or for services actually performed . . . .

12 U.S.C. § 2607(c)(1) & (2). At issue in this case is whether payment of a YSP violates RESPA's prohibition against referral fees, or whether a YSP might satisfy RESPA's qualification of payments for goods and facilities actually furnished or services actually performed, which payments are not prohibited. A brief explanation of the industry practice regarding YSPs provides helpful insight.

In the arena of retail and wholesale mortgages, banks such as Standard Federal fund mortgage loans originated by mortgage brokers. Mortgage brokers provide origination services and bring a borrower and a lender together to complete a loan. The Department of Housing and Urban Development ("HUD") estimates that mortgage brokers initiate about half of all home mortgages each year in the United States. These brokers provide "various services in processing mortgage loans, such as filling out the application, ordering required reports and documents, counseling the borrower and participating in the loan closing." Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1

Regarding Lender Payments to Mortgage Brokers, 64 Fed.Reg. 10080, 10081 (March 1, 1999) (hereinafter "HUD Policy Statement I"). Brokers may also offer goods and facilities such as office space and equipment to carry out loan-making functions. *Id.*

Brokers are entitled to compensation for their work and borrowers may choose to pay these fees in a variety of ways. The fees may be paid out-of-pocket by the borrower, they may be financed by adding the amount of such fees to the principal balance of their loan, or they may be paid indirectly by the borrower by way of a YSP paid by the lender to the broker. The second approach may not be available to all borrowers, however, if their loan-to-value ratio has already reached the maximum permitted by the lender. The payment of a YSP from the lender to the broker permits homebuyers to pay some or all of the up-front settlement costs over the life of the mortgage through a higher interest rate. HUD Policy Statement I, at 10081.

In determining the amount of YSP to pay, wholesale lenders such as Standard Federal establish a wholesale price for originating loans and communicate this pricing schedule to brokers through daily rate sheets. Rate sheets set forth the amount that the wholesale lender will pay brokers for various types of mortgage loans, taking into account a number of variables. These rate sheets discuss loans in terms of "above par," "at par," and "below par."[3] "The term 'par rate' refers to the rate offered to the broker . . . at which the lender will fund 100% of the loan with no premiums or discounts to the broker." HUD Policy Statement I, at 10081, n.1. If "the mortgage carries a higher interest rate, the lender is

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[3] Although both parties to this appeal refer to these three rate terms in briefing, our examination of the record fails to disclose that rate sheets, if any, available to the district court actually set forth these three rates. The Glovers offer to supplement the record with a series of Standard Federal rate sheets, an offer we have declined, but even these papers appear to contain only a single, published base rate for each type of loan available.

able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference." Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed.Reg. 53052, 53054 (October 18, 2001) (hereinafter "HUD Policy Statement II").

Regardless of how the broker compensation is handled, all costs are ultimately paid by the borrower, whether through direct fees paid to the broker, through the loan principal or through the interest rate arranged with the lender. So, when a mortgage broker originates a loan above par, the broker receives a YSP payment from the mortgage lender which is based upon the daily rate sheet and the interest rate of each loan offered by the broker to the borrower. HUD Policy Statement I, at 10081. In this way, as earlier indicated, the borrower indirectly finances the amount of that premium through the mortgage lender so as to avoid the necessity of a direct payment to her broker, thereby reducing the amount of out-of-pocket expenses required at, or prior to, closing. *Id.* Some consumers, like the Glovers, allege that this compensation system is illegal under RESPA because it fosters the payment of prohibited referral fees. Others view this practice as an option that fosters homeownership because it reduces the amount of money required from borrowers up-front and out-of-pocket. HUD Policy Statement II, at 53054. In any event, wholesale lenders such as Standard Federal claim, and apparently stand ready to attempt to prove at trial, that they ultimately receive the same compensation from each loan, whether or not a YSP is paid as part of the transaction. This is because, they argue, the increased amounts received from secondary investors for a higher interest rate loan are, as noted by HUD Policy Statement II, usually passed along to the broker for services rendered.

II. DISCUSSION

A. Jurisdiction

Pursuant to Federal Rule of Civil Procedure 23(f), "[a] court of appeals may in its discretion permit an appeal from an order of a district court granting or denying class action certification . . . if application is made to it within ten days after entry of the order." The Glovers argue that this court lacks jurisdiction to review the district court's September 26, 2000, order because it was not an order granting or denying class certification. We disagree.

Rule 23(a) of the Federal Rules of Civil Procedure sets forth the threshold requirements for certification of a class. A class may be certified if:

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

In addition, to maintain a class action the court must find that one of the requisites of Rule 23(b) is present, among them being that "questions of law or fact common to the members of the class predominate over any questions affecting only individual members." Fed.R.Civ.P. 23(b)(3).

On March 22, 2000, the district court held that the Glovers met their burden under Rule 23 and defined the potential class as all people obtaining a mortgage brokered by Heartland and financed by Standard Federal under circumstances which gave rise to any of the type of incentive payments described in the complaint. On September 26, 2000, pursuant to a request by the Glovers to clarify the class, the district court recognized it did not previously define the class as the Glovers requested. The district court concluded that a nationwide

class was consistent with the common questions of law and fact discussed in the March 22, 2000, order, and certified a nationwide class of "all people obtaining a mortgage during the appropriate time period, financed by Standard Federal Bank under circumstances which gave rise to yield spread premiums or service release premiums, and brokered by *any* mortgage broker pursuant to a Correspondent Agreement identical to the Correspondent Agreement between Standard Federal Bank to Heartland Mortgage Corp." Appellant's Addendum at 30-31 (emphasis added).

The district court order at issue does not merely deal with a clarification of the scope and contour of the class as the Glovers profess. The September 26, 2000, order opens up the class to individuals working through an entire network of mortgage brokers across the nation beyond the more limited group, outlined in the March 22, 2000, order, of those individuals who obtained a mortgage brokered only by Heartland. Clearly, as to both these newly defined class members and those described on March 22, the September 26 order constitutes class certification. The district court labeling the order a clarification does not change this fact.

As we have done on two previous occasions in this case, we find jurisdiction pursuant to Federal Rule of Civil Procedure 23(f) appropriate to review the district court order granting class certification.

B. Standard of Review

We review a district court's ruling granting or denying class certification for abuse of discretion. *Chaffin v. Rheem Mfg. Co.*, 904 F.2d 1269, 1275 (8th Cir.1990).

C. Measure of Deference Provided HUD's Statements of Policy

In March 1999, and again in October 2001, HUD issued Statements of Policy regarding lender payments to mortgage brokers. HUD's Policy Statement I responded to a Conference Report on the Departments of

Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, directing HUD to clarify its position on lender payments to mortgage brokers.[4] In October 2001, HUD published Policy Statement II in order to "eliminate any ambiguity concerning the Department's position with respect to those lender payments to mortgage brokers characterized as yield spread premiums . . . as a result of questions raised by two recent court decisions, *Culpepper v. Irwin Mortgage Corp.* and *Echevarria v. Chicago Title and Trust Co.*, respectively." HUD Policy Statement II, at 53052. Policy Statement II specifically expresses HUD's disagreement with the judicial interpretation regarding Section 8 of RESPA and the 1999 Statement of Policy as set forth in Culpepper. *Id.* at 53054-55.

Whether or not we follow HUD's Policy Statements is dispositive in this case because if we endorse the two-part test advocated by HUD, the inquiry in each case must necessarily be made on a loan-by-loan basis, there-

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[4] Notwithstanding the fact that HUD issued its Policy Statement at the directive of a Conference Report, we apply only the standards set by legal precedent in determining the measure of deference to give HUD's communication. The statement that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of . . . RESPA," constitutes only a congressional committee's post facto interpretation of the law. Congress may not conscript agencies to legislate for it. If Congress wishes to legislate conclusively, it must do so directly. A statement made by Congress after the legislative process does not have the force of law and is almost wholly unpersuasive. Reviewing courts must also be careful not to allow an agency to create *de facto* new regulations under the guise of interpreting an earlier regulation. *See Christensen v. Harris County*, 529 U.S. 576, 588, 120 S.Ct. 1655, 14[illegible] Ed.2d 621 (2000). HUD most appropriately expresses its concern [illegible] this matter in its 1999 Statement of Policy when it states its own belief that "broad legislative reform . . . remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and the Truth in Lending Act (TILA) for industry and consumers alike." HUD Policy Statement I, at 10080. Our decision today credits HUD's Policy Statements with only the amount of deference due an agency's interpretation of its own regulation, as established by the Supreme Court. *See Christensen*, 529 U.S. 576, 120 S.Ct. 1655, 146 L.Ed.2d 621.

fore eliminating class treatment. The Glovers argue that the Policy Statements issued by HUD are contrary to RESPA and are thus entitled to no deference.

HUD Policy Statement I sets forth a two-part test to determine whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA:

> [T]he first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.
>
> In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets.

HUD Policy Statement I, at 10084.

HUD Policy Statement II sets forth, among other things, the following clarification of the HUD test contained in Policy Statement I:

1. *The First Part of the HUD Test:*

> Under the first part of HUD's test, the total compensation to a mortgage broker, of which a yield spread premium may be a component or the entire amount, must be for goods or facilities provided or services performed. HUD's position is that in order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed by the broker in the transaction, whether the goods, facilities or services are paid for by the borrower, the lender, or partly by both.
>
> It is HUD's position that neither Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed.
>
> . . .
>
> Whether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD's test applies to the transaction involved.

HUD Policy Statement II, at 53055.

When reviewing an agency's construction of a statute it administers, a court must first ask whether Congress has directly spoken to the precise question at issue. *Chevron U.S.A., Inc. v. Natural Res. Defense Council, Inc.*, 467 U.S. 837, 842, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). The legality of a YSP payment (or any other specific type of payment) to a mortgage broker is not directly addressed by RESPA. Neither is how one deals with the tension created by the words of Sections 8(a)

and 8(c). Thus, the intent of Congress on this issue is not expressly set forth in the statute. Therefore, under *Chevron*, we must determine whether HUD's analysis as set forth in its regulation is based on a permissible construction of the statute. *Id.* at 843, 104 S.Ct. 2778.[5]

"If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation." *Id.* at 843-44, 104 S.Ct. 2778. Agency regulations promulgated under express congressional authority are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. *Id.* at 844, 104 S.Ct. 2778. In the instant case, it appears Congress did intend to delegate authority to HUD by expressly authorizing HUD to "prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of [RESPA]." 12 U.S.C. § 2617(a). HUD promulgated rules under RESPA at 24 C.F.R. § 3500.1 *et. seq.*, subject to notice-and-comment. Because these rules were promulgated under the express authority of Congress and adjudicated with apparent congressional intent to carry the force of law, they are accorded *Chevron* deference. *United States v. Mead Corp.*, 533 U.S. 218, 121 S.Ct. 2164, 2172, 150 L.Ed.2d 292 (2001). However, these regulations are not directly at issue today, as the language of the Section 8(a) regulation issued by HUD simply mirrors that of the statute.[6]

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[5] If the statute is unambiguous, as claimed by the Glovers, we think, as later explained, any lack of ambiguity runs in the direction of HUD's construction of the law and not the analysis advanced by the Glovers.

[6] Section 3500.14(b) mirrors Congress' directive in 12 U.S.C. § 2607 and states "[n]o person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person." Like the statute, the regulation makes no attempt to further define or describe the nature or character of the type of payment that would or would not be a prohibited "referral" fee.

We are called upon today to review HUD's two Statements of Policy, which interpret HUD's own regulations promulgated under RESPA and which set forth the two-part test, to determine whether, or under what circumstance, a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA. "[I]nterpretations contained in policy statements . . . which lack the force of law – do not warrant *Chevron*-style deference." *Christensen v. Harris County*, 529 U.S. 576, 587, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000) (citing *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 256-258, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991) (measuring deference given an EEOC policy statement interpreting a statute on *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944) standards and not *Chevron* standards)).

In this case, however, we have a duly promulgated regulation, which has the force of law under *Chevron*, but which for our purposes continues the statutory ambiguity. It remains unstated and unclear under the regulation, as under the statute, whether payment of a YSP to a mortgage broker does, or must, in whole or in part, constitute an unearned fee. Thus we are not dealing with *Mead*, and its corresponding line of cases, which address the issue of deference due regulations or other congressionally authorized interpretations of a guiding statute. *See Mead*, 533 U.S. 218, 121 S.Ct. 2164, 150 L.Ed.2d 292; *Chevron*, 467 U.S. at 842, 104 S.Ct. 2778; *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944) (giving lesser agency rulings, statements, interpretations and opinions concerning statutory meaning deference only proportional to their power to persuade given the agency's specialized experience, investigations and available information).

We look, instead, to *Bowles v. Seminole Rock & Sand Co.* and its progeny for guidance in determining what deference is due an agency interpretation of its own ambiguous regulation. *See Christensen*, 529 U.S. at 588, 120 S.Ct. 1655 (giving deference to an agency's

interpretation of its own regulation only if the language of the regulation is ambiguous); *Auer v. Robbins*, 519 U.S. 452, 461, 117 S.Ct. 905, 137 L.Ed.2d 79 (1997) (giving controlling deference to an agency's interpretation of its own ambiguous regulation unless plainly erroneous or inconsistent with the regulation); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413-14, 65 S.Ct. 1215, 89 L.Ed. 1700 (1945) ("Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt. . . . [T]he ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation."). Referring to this line of cases, we believe that HUD's Policy Statements interpreting its own ambiguous regulation are controlling authority unless they are plainly erroneous or inconsistent with the regulation or the purpose of RESPA. *Christensen*, 529 U.S. at 588, 120 S.Ct. 1655 (construing *Auer v. Robbins*, 519 U.S. at 462, 117 S.Ct. 905).

However, if *Christensen* does not contemplate situations, as here, where the agency regulation does nothing more than mirror the ambiguous language of the statute, our decision to give deference to HUD's Policy Statements remains steadfast. *See Cunningham v. Scibana*, 259 F.3d 303, 307 n.1 (4th Cir.2001) (holding that *Christensen* does not apply if there is no ambiguous interpretive language in the regulation, that is if the agency "simply repeated the statutory language in the regulation and left its interpretation of [the statutory language] to a program [or policy] statement," *Skidmore* principles apply). HUD's Policy Statements in this instance pack sufficient power to persuade given HUD's specialized mission, experience and broad investigation into the consumer lending market. *Skidmore*, 323 U.S. at 140, 65 S.Ct. 161.

In sum then, applying either *Christensen* or *Skidmore*, we find that the Policy Statements issued by HUD

reflect a reasoned view of a responsible agency which is consistent with the statute and the regulation and which constitutes a body of experience and informed judgment that this court may look to as determinative authority. And, we do so.

D. The Policy Statements

The Glovers reject HUD's analysis. In support of the district court's decision, the Glovers argue that under the plain language of RESPA, the first inquiry is always whether the YSP premium is payment *for* a prohibited referral rather than *for* facilities, goods and services. If the YSP is really a referral fee, the payment violates RESPA regardless of the fact that the broker may actually perform services. Thus, the first inquiry, says the Glovers, focuses not on whether facilities, goods and services were provided, but on what the payment is *for*.

The Glovers further argue that evidence of the nature, value and reasonableness of facilities, goods and services provided in a particular transaction is essentially irrelevant in this first inquiry. They assert that because the total dollar amount of a YSP paid to a broker depends solely on the rate of interest brokered for the borrower, and because the payment of these premiums by Standard Federal is based upon a course of business guided by identical Correspondent Agreements, there is no need for an individualized inquiry. Class certification is appropriate, they say, because this evidence establishes that the YSP premium is payment *for* a referral, thus raising at least a presumption of liability. These are the questions of fact that preponderate, they contend. The Glovers allege that Standard Federal's practice focuses on a systematic marketing program of paying repeated fees and bonuses based only on the value and frequency of referrals without knowledge of

the quantity or quality of services provided by each mortgage broker.[7]

The Eleventh Circuit has arguably endorsed at least part of this line of reasoning in its recent decision in *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir.2001), *cert. denied*, --- U.S. ---, 122 S.Ct. 930, 151 L.Ed.2d 893 (2002). In *Culpepper*, a panel of the circuit affirmed class certification in a similar case where mortgagors brought a class action against a mortgage lender, arguing that the lender's payment of YSPs to a mortgage broker violated the anti-kickback provision of RESPA. *Id.*[8] The court rejected the lender's contrary argument, stating "[i]f [the lender] has read the HUD Statement correctly . . . HUD has now decided that § 8(c) deems *some* such referral fees legal-that is, referral fees that are paid by lenders and that would be reasonable service fees, if that's what they were." *Id.* at 1330. The Eleventh Circuit interpreted HUD Policy Statement I, an interpretation now repudiated by HUD, *see* HUD Policy Statement II, and ultimately found that "the first step in the test for liability under § 8 is not only whether the broker performed some of the services described in the HUD Statement, but also whether the yield spread premium is payment for those services rather than for a referral." *Culpepper*, 253 F.3d at 1331. The court in *Culpepper* reasoned that if the purpose of the lender payment is only for referrals and not for

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[7] In their briefing and supplemental submissions in this case, the Glovers make much of the fact that Standard Federal pays bonuses to their network of brokers as generalized proof of prohibited payments under RESPA. However, the name given any payment to a broker is not the important issue under RESPA. We look at the total compensation, whatever its form. *See* HUD Policy Statement I, at 10084.

[8] There is, perhaps, a significant factual difference in *Culpepper*. There, the class consists of "persons who . . . obtained . . . [a] loan . . . wherein the broker was paid [presumably by the borrower] a loan origination fee of 1% or more and wherein [the lender] paid a 'yield spread premium' to [the] mortgage broker." 253 F.3d at 1326. No such loan origination fee is required for membership in the proposed class in this case.

services, you do not get to step two of HUD's two-part test. *Id.* Under this interpretation, focusing only on a purported search for the lender's intent in each case, *Culpepper* found that similar questions of fact predominate, justifying class treatment.[9]

Both the Eleventh Circuit and the Glovers profess that they adopt HUD's statement that YSPs are not "per se" illegal. HUD Policy Statement I at 10084, *Culpepper*, 253 F.3d at 1331, Appellees' Brief at 64. In doing so, they advance a few factual scenarios under which they claim a YSP payment might pass muster under RESPA. Given the gloss the Glovers would place on RESPA, we are not persuaded that they describe realistic examples. In the context of the residential loan industry as it exists today, we have difficulty seeing many, if any, factual situations in which a YSP could lawfully coexist with their contentions. Using the Glovers' interpretation of the statute, inventive minds making clever arguments can turn virtually *any* payment flowing from a lender to a broker, in connection with the placement of a mortgage loan, into a purported payment for the unlawful referral of business. However, Section 8(c) clashes with this result. It clearly states that reasonable payments for goods, facilities or services actually furnished are *not prohibited* by RESPA, even when done in connection with the referral of a particular loan to a particular lender. The Glovers' approach tends

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[9] We note, however, that for this case *Culpepper* does not appear to be apposite precedent. The Eleventh Circuit, in its exercise interpreting HUD Policy Statement I, appears to have given at least some deference to HUD policy pronouncements. But, *Culpepper* was considered and published prior to HUD's more recent Policy Statement of October 18, 2001, a policy that we believe is due either *Christensen* or *Skidmore* deference. As previously noted, the court in *Culpepper* reached its final conclusion by finding HUD's two-part test "ambiguous" thus leaving room for the court to inject its own interpretation of HUD's intent. The Eleventh Circuit has not stated its position regarding the deference due HUD Policy Statement II. We will not conjecture whether it will remain steadfast in its position regarding the ambiguity of HUD's Policy Statement now that HUD has clearly stated that it differs with the analysis made in *Culpepper*.

to turn the interrelated sections upside down, putting total emphasis on the prohibitory language of Section 8(a) and no emphasis on the permissive language of Section 8(c).

HUD's Policy Statements, on the other hand, reconcile both facets of RESPA policy. HUD requires a determination of whether goods or facilities were actually furnished or services were actually performed and whether the amounts of the payments are reasonably related to the value of these goods, facilities, or services. HUD Policy Statement I, at 10084; HUD Policy Statement II, at 53054. We agree with this approach because we believe that one cannot take a tightly focused look at but one side of the prohibited/permitted equation. A lender's reliance on a rate sheet to uniformly offer and calculate a YSP payable to a broker does not, without more, mean that class certification is appropriate. Nor does it mean that you can presume that each payment reflects payment of a prohibited referral fee simply because the lender does not have specific knowledge of the nature and amount of service the broker performs in conjunction with a particular loan or group of loans. HUD Policy Statement II, at 53055. Like HUD, we doubt that many, if any, lenders are ignorant of the fact that brokers perform many unique services during these transactions, in addition to bringing the borrower and lender together. HUD Policy Statement II, at 53055. Indeed, the preliminary and closing papers in each transaction identify and quantify services performed, facilities used and goods supplied. In fact, the predominant reason lenders use brokers at all is to provide borrowers the necessary goods, services and facilities that the lender itself chooses not to offer, for economic or other business-related reasons.

Contrary to the Glovers' argument, HUD's two-part test is fully consistent with RESPA. Reviewing services performed and their value on a case-by-case basis does not run afoul of the proscription stated in Section 8(a) prohibiting payments for referrals. Nor does it mean

that you retroactively purify unlawful referral fees by offsetting their existence against the performance of legitimate settlement services. Indeed, the Glovers' course effectively writes Section 8(c) out of RESPA. As noted, Section 8(c) clearly anticipates payments to individuals for goods or facilities actually furnished or for services actually performed, and specifically excludes these payments from the Section 8(a) proscription. 12 U.S.C. § 2607(c)(2). Nothing in RESPA prohibits such payments in the mode of a YSP, or in any other particular form, and HUD's test simply helps determine whether the YSP, by its existence, use and amount, falls within or without the permissive boundaries of Section 8(c).

We reject the Glovers' claim that HUD's policy provides a self-serving reasonability valuation system operating within a discrete mortgage lender/broker market, a system that drowns any reasonability standard in a sea of broker-only comparisons. This argument is unsupported. The analysis will necessarily involve values affixed to the same or similar goods, facilities or services both within and without the local mortgage broker industry. If total compensation paid by the lender to the broker in a given transaction exceeds a reasonable amount for the goods, services and facilities provided, it is likely that a RESPA violation has been established. American courts have accurately and fairly determined reasonability in similar situations since their inception, and they will do so in the Glovers' case, if necessary.

If HUD's step one analysis is not undertaken prior to a class-wide pronouncement of RESPA liability, it is almost certain that at least some legitimate Section 8(c) activities now performed by mortgage brokers will be left uncompensated. Should this occur, the present borrower/broker/lender relationship will disintegrate, at least for those buyers who must borrow above par in order to finance settlement services.

Under HUD policy, the Glovers and the individual members of the proposed class are far from unprotected

by RESPA. If the case-specific inquiry establishes at step one that no compensable services were performed in return for the YSP, the inquiry ends and a violation is probably made out. If compensable goods, facilities or services are provided, HUD's step two leads to a RESPA remedy if any part of the total payment, including the YSP, proves to be excessive and, thus, an unlawful referral fee. And, even though each RESPA violation will usually not yield a large judgment, Congress has guaranteed legal representation under RESPA by permitting attorneys fees and costs as part of each allowable recovery. 12 U.S.C. § 2607(d)(5). This permits and encourages individual consumers to raise valid RESPA claims. Accordingly, a class action is not necessary for justice to be done.

Finally, a loan-specific inquiry to determine liability under RESPA is further supported by RESPA's own directions for a loan-specific inquiry to measure damages. Section 2607(d)(2) of RESPA calculates damages for a violation of the act "equal to three times the amount of any charge paid for such settlement service." The plain language of RESPA, then, demands that there be a determination of which settlement services are provided in connection with each real estate settlement including such things as title searches, title examinations, the preparation of documents, property surveys, and other potential services defined at section 2602(3). It appears, therefore, that RESPA anticipates an inquiry into the services provided in order to determine whether a prohibited referral occurred in the first instance, and also to determine the amount of damages warranted, if any. This loan-specific analysis is required to determine civil liability as well as to measure damages under RESPA.

We reject the analysis in *Culpepper*, and while it remains the law in the Eleventh Circuit, we choose a different conclusion, giving due deference to HUD's interpretations of its regulations.

III. CONCLUSION

We accept the loan-specific liability test promulgated by HUD, which recognizes that YSPs may be used as a way to finance closing costs. Accordingly, a loan-specific analysis is required in determining whether the payment of a YSP is based upon services rendered or an illegal referral. We do not surmise that the payment of a YSP will pass muster in each instance, or even in this case. We further emphasize that our opinion today in no way prohibits individual plaintiffs from pursuing their valid claims under RESPA. As noted, Congress, in its wisdom, fosters the guarantee of legal representation under RESPA on an individual basis by allowing for attorneys fees and costs as part of the prescribed recovery. Our only conclusion today is that the determination must be made on a loan-by-loan basis. Class certification being impracticable, the judgment of the district court is reversed. We remand for further action consistent with this opinion.[10]

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[10] We have been inundated with communications from counsel in this case, mostly submitted under the guise of court rule 28(j). Many if not most of this myriad upon myriad of filings violate both the language and spirit of the rule. Because of the importance of this matter to the parties and the residential mortgage industry, however, we have examined each submission and leave to another day the question of sanctions for this type of violation.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)

LONNIE GLOVER, DAWN GLOVER, AND
ALL OTHERS SIMILARLY SITUATED,
Plaintiffs,

v.

STANDARD FEDERAL BANK
AND HEARTLAND MORTGAGE,
Defendants.

[September 26, 2000]

MEMORANDUM OPINION AND ORDER

The above-entitled matter is before the Court on Defendant Standard Federal Bank's Motion to Stay Proceedings and to Limit Class Definition and Plaintiffs' Request for Clarification of the Class Definition. In the Complaint, Plaintiffs allege violations of the anti-kickback and fee-splitting provisions of Section 8 of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607; violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961, *et seq.*; deceptive and unfair trading practices in violation of Minn. Stat. § 325D.44, Minn. Stat. § 325F.67, and the Michigan Consumer Protection Act; and common law unjust enrichment. In an Order dated March 22, 2000, this Court granted Defendant Standard Federal's Motion for Summary Judgment as to all claims except those under RESPA and granted Plaintiffs' Motion for Class Certification.

In the March 22, 2000, Order, the Court defined the Plaintiff Class as all people obtaining a mortgage

brokered by Heartland and financed by Standard Federal Bank under circumstances which gave rise to any of the types of incentive payments described in the Complaint. This definition is not consistent with the request of the Plaintiffs, which was to certify a nation-wide class of all individuals obtaining a mortgage financed by Standard Federal Bank under circumstances which gave rise to any of the types of incentive payments described in the Complaint, regardless of the mortgage broker. Standard Federal Bank would like the Court to reassert that the Class is limited to people obtaining Standard Federal mortgages brokered by Heartland. The Plaintiffs would like the Court to clarify that the Class should be defined without respect to the mortgage broker.

The Court has reviewed the record in this matter, as well as the briefs submitted by the parties in response to the instant motions, and concludes that Plaintiffs are correct. When this Court issued its March 22, 2000, Order, the Court focused most of its attention on the question briefed by the parties: whether these issues could be resolved on a class-wide basis at all. Having answered that question in the affirmative, the Court took its cue from the fact that Heartland Mortgage is a named Defendant in this action and defined the class around the nexus of the two Defendants. However, the Plaintiffs had originally moved for a nation-wide class, and the Court concludes that such a class is entirely consistent with the common questions of law and fact described by the Court in the March 22, 2000, Order. To the extent that the Court found such common questions of law and fact, they are not contingent upon the identity of the mortgage broker. Rather, the common questions of law and fact derive from the use of a standard "Correspondent Agreement" by Standard Federal Bank. Accordingly, a class of individuals who obtained a mortgage financed by Standard Federal Bank and brokered by *any* mortgage broker is appropriate, so long as the brokers were party to identical Correspondent

Agreements. The Court's March 22, 2000, Order should be modified accordingly.

Defendant Standard Federal Bank further requests that this Court stay proceedings in this matter pending the 11th Circuit's decision in *Culpepper v. Inland Mortgage Corp.*, 132 F.3d 692 (11th Cir. 1998), clarified by 144 F.3d 717 (11th Cir. 1998). Standard Federal Bank clearly hopes that the *Culpepper* decision will shed some light on the question of whether suits such as this are amenable to class consideration. While this Court considered the reasoning advanced in the cases out of the 11th Circuit in reaching its conclusion that class certification was appropriate, the Court's analysis is its own and a holding from another Circuit will not change this Court's position. Accordingly, the Court finds that a stay of these proceedings would serve no purpose.

For the reasons stated, **IT IS HEREBY ORDERED**:

1. Defendant Standard Federal Bank's Motion to Stay Proceedings and to Limit Class Definition (Doc. No. 102) is **DENIED**;

2. Plaintiff's Request for Clarification of the Class Definition is **GRANTED**; and

3. The Class Certified by this Court's Order of March 22, 2000, is defined as "all people obtaining a mortgage during the appropriate time period, financed by Standard Federal Bank under circumstances which gave rise to yield spread premiums or service release premiums, and brokered by any mortgage broker pursuant to a Correspondent Agreement identical to the Correspondent Agreement between Standard Federal Bank to Heartland Mortgage Corp."

Dated: September 26, 2000

/s/ DONOVAN W. FRANK
Donovan W. Frank
Judge of United States
District Court

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)
LONNIE AND DAWN GLOVER,
Plaintiffs,

v.

STANDARD FEDERAL BANK, ET AL.,
Defendants.

[May 31, 2000]

ORDER

This matter came on for consideration before the undersigned upon the motion of Defendant Standard Federal Bank ("Standard Federal") for a revision to the Court's March 22, 2000 Order and for a stay of further proceedings in this Court. Based upon the arguments of Counsel, upon 28 U.S.C. § 1292(b), and upon the files, records, and proceedings herein, the Court being fully advised in the premises,

IT IS HEREBY ORDERED:

1. That the Court's March 22, 2000 Order is incorporated herein by reference, with the addition of the express clarification (i) that the Order, including but not limited to the portion thereof denying summary judgment to Standard Federal, involves a controlling question of law as to which there is substantial ground for difference of opinion, and (ii) that an immediate appeal of the summary judgment denial may materially advance the ultimate termination of the litigation; and

2. That all further proceedings in this case shall be stayed pending a decision by the Eighth Circuit Court of

Appeals on any appeals in this case or, if the Court of Appeals denies Standard Federal's petitions for immediate review, until the it [*sic*] renders a decision on the pending appeal in *Yasgur v. Aegis Mortgage Corp.*, 00-1760 (8th Cir.).

Dated: May 31, 2000 /s/ DONOVAN W. FRANK

Judge of United States
District Court

APPENDIX D

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)

LONNIE GLOVER, DAWN GLOVER, AND
ALL OTHERS SIMILARLY SITUATED,
Plaintiffs,

v.

STANDARD FEDERAL BANK
AND HEARTLAND MORTGAGE,
Defendants.

[March 22, 2000]

MEMORANDUM OPINION AND ORDER

Introduction

The above-entitled matter came on for hearing before the undersigned United States District Judge on March 10, 2000, pursuant to Plaintiffs' Renewed Motion for Class Certification, Plaintiffs' Motion for Summary Judgment, and Defendant Standard Federal Bank's Motion for Summary Judgment. In the Complaint, Plaintiffs allege violations of the anti-kickback and fee-splitting provisions of Section 8 of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607; violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961, *et seq.*; deceptive and unfair trading practices in violation of Minn. Stat. § 325D.44, Minn. Stat. § 325F.67, and the Michigan Consumer Protection Act; and common law unjust enrichment. For the reasons set forth below, Plaintiffs' motion for class certification is granted, Plaintiffs' motion for summary judgment is denied, and

Defendant Standard Federal Bank's motion for summary judgment is granted in part and denied in part.

Background

Named Plaintiffs Lonnie and Dawn Glover acquired a mortgage for their home in the late 1980s. They refinanced their mortgage in 1990, 1993, and again in 1996. The 1996 refinancing is at issue here. In that instance, they moved from an adjustable rate mortgage to a fixed rate mortgage.

Defendant Heartland Mortgage ("Heartland") brokered the 1996 refinancing. Defendant Standard Federal Bank ("Standard Federal") is a lender which funded and acquired the 1996 mortgage; Standard Federal also services mortgages. Indeed, Standard Federal generally sells the mortgages which it funds and acquires from brokers to third parties, but typically retains the servicing rights on the mortgages.

In the instant case, pursuant to pricing sheets distributed by Standard Federal to the various brokers with which it does business, Heartland brokered a mortgage for the Plaintiffs with an "above par" interest rate and was subsequently paid a "yield spread premium" by Standard Federal. This yield spread premium is one focus of this dispute.

According to the Plaintiffs, the yield spread premium is tantamount to a kickback given to brokers for negotiating mortgages with interest rates which are disadvantageous to borrowers. The Real Estate Settlement Procedures Act (RESPA), 27 U.S.C. § 2601, *et seq.*, states in pertinent part:

> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person. . . . No person shall give and no person shall accept any portion,

> split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.

27 U.S.C. §§ 2607(a) and 2607(b). According to the Plaintiffs, the yield spread premium — which is paid only for mortgages brokered at an "above par" interest rate and which varies based upon the interest rate itself and the amount of the mortgage — is a *per se* violation of RESPA. Specifically, they argue: (1) that the cost of brokering a mortgage is not dependent on the interest rate obtained (i.e., it does not cost more to broker a higher interest mortgage); (2) the yield spread premiums are only paid for above-par interest rates; and (3) the mortgage broker is not selling the lender a more valuable mortgage because the broker never actually owns the mortgage.

Defendants, in contrast, assert that the yield spread premium is not a kickback at all but rather is part of an overall package of compensation to the broker for services provided by the broker. In support of their position, Defendants note that higher interest mortgages are not necessarily more valuable because many of them are paid off early or refinanced so the income stream and servicing fees from them is actually smaller. Furthermore, the yield spread premium is given to the broker in lieu of the borrower paying higher up-front costs (i.e., instead of the borrower paying a lot to the broker up front, the lender pays the broker the yield spread premium and eventually recovers this cost from the higher interest paid by the borrower). Finally, Defendants note that the Department of Housing and Urban Development ("HUD") (the agency which enforces RESPA) specifically provides guidelines for the disclosure of yield spread premiums, and HUD would not be likely to provide guidelines for the disclosure of an illegal practice. Defendants do not dispute that yield spread premiums *can* violate RESPA under some

circumstances, but argue that the determination of whether a particular yield spread premium is a violation must be made on a case-by-case basis.

In addition to the yield spread premium for above-par interest rates, the Plaintiffs take issue with the following practices: (1) the payment of service release premiums for mortgages which assign the servicing rights to Standard Federal[1]; (2) the payment of bonuses or "enhanced" yield spread premiums for brokered mortgages over $ 100,000[2]; (3) the payment of additional bonuses for new purchase loans (as opposed to refinancing), mortgages in choice geographic regions, and mortgages secured by "preferred brokers"; and (4) alleged fee splitting by Standard Federal in relation to underwriting and document preparation.[3]

Discussion

1. Class Certification

Rule 23(a) of the Federal Rules of Civil Procedure sets forth the threshold requirements for certification of a class:

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of

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[1] According to Plaintiffs, these are referral fees. Again, Plaintiffs argue that the broker does not own any transferable right in the mortgage's servicing prior to closing. In other words, Standard Federal cannot be paying the brokers (here, Heartland) for a good — the servicing rights to the mortgage — because the good does not exist prior to the closing at which point it is instantaneously the property of Standard Federal.

[2] Again, Plaintiffs assert these are prohibited referral fees because the broker does not own the more valuable mortgage and the services required to broker a higher mortgage do not cost any more to provide.

[3] Plaintiffs contend that Standard Federal directly charges borrowers $200 for underwriting and $150 for document preparation even though it often contracts out these services to third-parties who are paid only a portion of these fees.

the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

In addition to these threshold requirements, a class action is only appropriate if one of the circumstances set forth in Rule 23(b) is present. The Plaintiffs here assert their motion for class certification based upon Rule 23(b)(3) which requires the Court to find "that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members . . . ."

In an Order dated August 26, 1999 (Doc. No. 52), this Court denied an earlier motion by Plaintiffs to certify a Plaintiff Class on the ground that the Plaintiffs had failed to demonstrate that common questions of law or fact predominated.[4] In that Order, the Court went into some detail regarding the history related to the burgeoning mass of RESPA litigation on yield spread premiums and the appropriate standard of analysis to apply to RESPA challenges of yield spread premiums. Without devoting significant time to rehashing that history lesson, the Court simply notes that there are two possible standards which can be applied in these cases.

The first test was articulated by the Eleventh Circuit in *Culpepper v. Inland Mortgage Corp.*, 132 F.3d 692, 696-97 (11th Cir.), as modified, 144 F.3d 717 (1998). Under the so-called "*Culpepper* test" the fact finder was called upon to determine whether the payment was for a good or service rendered; if the payment was not associated with some good or service, then the payment violated RESPA. If the payment was associated with a good or service, then the fact-finder had to determine whether the payment was reasonable; if the payment was unreasonably high relative to the good or service

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[4] The Plaintiffs sought interlocutory review of the denial of class certification from the Eighth Circuit; although this Court would have welcomed the Eighth Circuit's guidance on this matter, the Eighth Circuit declined to grant such review.

associated with it, then the payment violated RESPA. Based upon that standard for assessing violations of RESPA, a number of courts granted class certification of these disputes. Specifically, these courts determined that generalized evidence regarding the fee schedules used by brokers and lenders could be used in the first step of the analysis.

In 1999, the Department of Housing and Urban Development issued a Policy Statement addressing, *inter alia*, the application of RESPA to yield spread premiums. Real Estate Settlement Procedures Act State of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers ("Policy Statement"), 64 Fed. Reg. 10080 (1999). In its Policy Statement, HUD appears to articulate its own two-part test for analyzing particular payments under RESPA: 2 F.3d 692, 696-97 (11th Cir.), as modified, 144 F.3d 717 (1998). Under the so-called "*Culpepper* test," the fact finder is first called upon to determine whether a particular payment was for a good or service rendered; if the payment was not associated with some good or service, then the payment violated RESPA. If the payment was associated with a good or service, then the fact-finder had to determine whether the payment was reasonable; if the payment was unreasonably high relative to the good or service associated with it, then the payment violated RESPA.

> In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

Policy Statement, 64 Fed. Reg. 10084. HUD later seems to elaborate upon the first prong of the test by stating that "the threshold question is whether there were goods or facilities actually furnished or services actually performed *for the total compensation paid* to the mortgage broker." *Id.* at 10085 (emphasis added). The critical difference between the apparently new HUD test and the test previously defined by the courts is the stringency of the first prong. Where the courts required some showing that each element of compensation paid to a broker could be tied to a good or service provided, HUD apparently requires only that the broker provide some good or service, without any accounting for particular payments. *See Levine v. North American Mortgage*, 1999 WL 454651 (D. Minn. 1999); *Schmitz v. Aegis Mortgage Corp.*, 48 F. Supp. 2d 877 (D. Minn. April 23, 1999).

In the wake of the HUD Policy Statement, the Courts in this District have thus far unanimously concluded that the HUD test is different from the Culpepper test; that the HUD test precludes class-wide determinations of the legality of yield spread premiums, requiring instead a case-by-case analysis of the appropriateness of total compensation; and that the HUD test is a legitimate interpretation of RESPA. *See Kroskin, et al. v. Aggressive Mortgage Corp.*, Civil No. 98-600 (MJD/AJB) (D. Minn. July 12, 1999); *Brancheau v. Residential Mortgage, et al.*, 182 F.R.D. 579 (D. Minn. July 1, 1999); *Levine v. North American Mortgage*, 1999 WL 454651, ___ F. Supp. 2d ___ (D. Minn. July 1, 1999); *Schmitz v. Aegis Mortgage Corp.*, 48 F. Supp. 2d 877 (D. Minn. Apr. 23, 1999); *Yasgur v. Aegis Mortgage Corp.*, Civil No. 98-121 (JMR/FLN) (D. Minn. March 9, 1999).[5]

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[5] The Court notes, however, that District Courts in the Northern District of Alabama have concluded that the HUD Policy Statement does not alter the *Culpepper* analysis. *Culpepper, et al. v. Inland Mortgage Corp.*, CV 96-BU-0917-S, CV 98-BU-2187-S (N.D. Ala. July 20, 1999); *Heimmermann v. First Union Mortgage Corp.*, CV-98-J-2357-NW (N.D. Ala. Aug. 13, 1999).

In its August 26, 1999, Order denying class certification, this Court expressed its concerns with the HUD test as defined by the courts in this District. Specifically, the Court stated:

> First, it is difficult to imagine the circumstances under which a broker will be involved in a mortgage transaction and yet provide no goods and render no services whatsoever; as a result, the first prong of the HUD-proposed analysis rings hollow. Second, in *Culpepper, et al. v. Inland Mortgage Corp.*, CV 96-BU-0917-S, CV 98-BU-2187-S (N.D. Ala. July 20, 1999) the district court noted that the HUD test (as construed by the majority of courts) gives rise to a potential inconsistency. Specifically, a lender could quite explicitly provide a kickback to a broker, but, under the "any services" and "total compensation" test, that kickback could actually be declared legal under the terms of RESPA if the broker happens to provide sufficient services to render the total compensation reasonable. In other words, regardless of the intent of the lender in giving money to the broker, the decision of whether the payment is illegal depends upon a whim of fate — whether, in the final analysis, the amount of money given to the broker in toto happens to be reasonable.

Nevertheless, the Court felt some obligation to ensure consistency at least within this District and thus held that the HUD test was less stringent than the *Culpepper* test, that the HUD test was not amenable to determination through class-based analysis, and that the HUD test (as described by the courts) was not an arbitrary and capricious interpretation of RESPA. As a result, the Court denied the Plaintiffs' motion for class certification on the basis that common questions of law and fact did not predominate.

The Plaintiffs have brought this renewed motion for class certification as a result of a letter dated December 17, 1999, from the General Counsel for HUD to a local congressman, the Honorable Bruce F. Vento (the "HUD

letter"). Congressman Vento wrote to HUD on behalf of several of his constituents, requesting a clarification of the HUD Policy Statement and its effects on the analysis of yield spread premiums under RESPA. HUD's General Counsel responded that "HUD did not intend for the Policy Statement to create a new legal standard or to change existing law." Affidavit of Hart L. Robinovitch, Exhibit A.

Although the Plaintiffs assert that the HUD letter clarifies HUD's Policy Statement and contradicts the interpretation of that Policy Statement which has been advanced in the courts of this District, the Court finds that the HUD letter does little to relieve the confusion over the appropriate standard for reviewing yield spread premiums under RESPA. Specifically, the HUD letter goes on to state, quite explicitly, that "the total compensation from the lender and the borrower should be scrutinized to assure that the payment is reasonably related to goods, facilities, or services furnished or performed." By referencing "total compensation," the HUD letter seems to be advancing a test different from the *Culpepper* test, a test which is significantly less stringent.

However, in light of this Court's earlier ambivalence regarding the appropriate standard to be applied, the Court has determined that a review of the matter is in order. At the outset, the Court notes that the HUD Policy Statement is open to interpretations different from that advanced by the other courts of this District. First, the Policy Statement's reference to "total compensation" does not necessarily mean that the courts must look at the compensation in its totality. Rather, that phrase could be read to require that the courts look at all of the compensation provided to the broker, from both the lender and the borrower, but to allow — perhaps even require — the courts to consider each element of that compensation, i.e., each quantum of compensation associated with a different good or service, separately. Second, the Court notes that, as the United

States District Court for the Northern District of Alabama pointed out in *Heimmermann v. First Union Mortgage Corporation, supra*, the HUD Policy Statement itself recognizes the potential for class based litigation when it notes that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." If the Court is to read the Policy Statement in such a way as to give effect to all of the language contained therein, the Court must reach the conclusion that HUD did not intend to articulate the less stringent test which has been adopted by the other courts of this District.

The Court further notes that the interpretation of the HUD Policy Statement advanced by the other courts in this District seems to have taken on a life of its own. A review of the decisions in this District reveals that most, if not all, of the other District Court Judges who have ruled on this matter have expressed the same ambivalence this Court expressed in its first Order. Thus, the Court concludes that in "breaking rank" with the other courts in the District, the Court is in reality not moving too far afield of the positions of the other Judges in the District.

Even if the Court were to conclude that HUD did intend to articulate a standard separate from the *Culpepper* test, a less stringent standard as defined in the courts in this District, the Court would be compelled to conclude that, in fact, such a standard is arbitrary and capricious. The Court must defer to an agency's interpretation of a program within its administrative purview, unless the agency's interpretation is irrational, arbitrary, capricious, or in conflict with the plain language of the statute. *See generally Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-45 (1984). As noted above in this Order, as noted by this Court in its Order of August 26, 1999, and as noted by the Courts of the Northern District of Alabama, the test articulated in the HUD Policy Statement — as construed by the Defendants in this case and

the courts of this District — simply makes no sense. Under such an interpretation, a lender could offer a broker an explicit kickback, but then justify that kickback *post hoc* by tying the "total compensation" to goods and services. Even if such an interpretation were not in conflict with the plain language of RESPA, it would surely qualify as irrational.

As a result, the Court concludes that the *Culpepper* test is the appropriate standard for determining whether particular payments or types of payments are legal under RESPA. The Court does not reach this conclusion lightly. Again, the Court recognizes that it is breaking with the decisions of the other courts in this District, and it does so respectfully. However, the Court feels compelled to follow its own reasoning in this matter. The fact that the Court's desire to retain intellectual integrity compels the Court to create a schism in the District highlights the need for a higher authority to settle the debate between *Culpepper* and the so-called "HUD test." In the meantime, the Court must go its own way and resurrect the *Culpepper* test in this District.

The *Culpepper* test clearly allows such determinations to be made on a class-wide basis where the method for calculating the compensation does not vary from mortgage to mortgage. The Defendants themselves note that the rate sheets which define the yield spread premiums and other "incentive payments" are not designed to be loan specific. The Defendants' own characterization of the rate sheets, then, would seem to weigh in favor of class certification. As a result, the Court concludes that common questions of law and fact predominate.

Moreover, the Court determines that Plaintiffs have met their burden in establishing that the requirements of Rule 23(a) have been met. First, the potential class, defined as all people obtaining a mortgage brokered by Heartland and financed by Standard Federal Bank under circumstances which gave rise to any of the types of incentive payments described in the Complaint, would be too numerous to make joinder practicable. Second, as

noted, there are questions of law and fact common to the claims of all potential class members. Moreover, the named Plaintiffs' claims are typical of the claims which could be brought by potential class members. Finally, the named Plaintiffs have demonstrated the zeal with which they will attempt to protect the interests of the class.

Accordingly, the Court determines that class certification is appropriate.

2. Standard of Review for Summary Judgment

Summary judgment is proper if there are no disputed issues of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The court must view the evidence and the inferences which may be reasonably drawn from the evidence in the light most favorable to the nonmoving party. *Enterprise Bank v. Magna Bank*, 92 F.3d 743, 747 (8th Cir. 1996). However, as the Supreme Court has stated, "summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to 'secure the just, speedy, and inexpensive determination of every action.'" Fed. R. Civ. P. 1. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986).

The moving party bears the burden of showing that there is no genuine issue of material fact and that it is entitled to judgment as a matter of law. *Enterprise Bank*, 92 F.3d at 747. The nonmoving party must demonstrate the existence of specific facts in the record which create a genuine issue for trial. *Krenik v. County of Le Sueur*, 47 F.3d 953, 957 (8th Cir. 1995). A party opposing a properly supported motion for summary judgment may not rest upon mere allegations or denials, but must set forth specific facts showing that there is a genuine issue for trial. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256 (1986); *Krenik*, 47 F.3d at 957.

3. Plaintiffs' Motion for Summary Judgment

Plaintiffs assert that the yield spread premiums at issue constitute per se violations of RESPA in that they are not associated with any compensable good or service provided by the broker. Accordingly, Plaintiffs request summary judgment on the matter of these particular RESPA violations.

Defendants have argued, however, that the yield spread premium is given to the broker in lieu of the borrower paying higher up-front costs (i.e., instead of the borrower paying a lot to the broker up front, the lender pays the broker the yield spread premium and eventually recovers this cost from the higher interest paid by the borrower). To the extent that the yield spread premium represents a way of redistributing up-front costs between the borrower and the lender, a fact finder could conclude that the yield spread premium is legitimate compensation for goods and services rendered.[6] At a minimum, this outstanding contention by the Defendants represents a genuine issue of material fact which precludes summary judgment in favor of the Plaintiffs on Plaintiffs' RESPA claims.

4. Defendant Standard Federal Bank's Motion for Summary Judgment

Standard Federal Bank has moved the Court for Summary Judgment on all the claims against it. At the outset, the Court notes that, for the reasons stated elsewhere in this memorandum, summary judgment on the Plaintiffs' RESPA claims is inappropriate at this time.

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[6] To make a legitimate claim that the yield spread premium is compensation for services rendered, the Defendants will ultimately need to demonstrate that borrowers who obtained higher interest loans actually paid brokers less up front and that their "discount" in up-front fees was commensurate with the additional cost of the higher interest rates. Contrary to the assertions of the Defendants, such analysis could be carried out on a class-wide basis through examination of the formulae used to determine the yield spread premiums and the up-front costs to borrowers.

Similarly, to the extent that Defendant Standard Federal Bank's motion for summary judgment on the remaining claims is premised upon the lack of viability of the predicate RESPA claims, the motion is denied. Standard Federal Bank has asserted independent grounds for summary judgment on the non-RESPA claims, however, and the Court will now consider whether summary judgment is appropriate for any non-RESPA related reasons.

a. RICO Claim

Plaintiffs have asserted a civil cause of action under RICO. Specifically, they assert that the Defendants violated 18 U.S.C. § 1962(c), which states:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

In order to assert a civil RICO action, Plaintiffs must show: (1) the existence of a RICO enterprise; (2) the existence of a pattern of racketeering activity; and (3) that the RICO violation was a proximate cause of an injury to the Plaintiffs. *See, e.g., Standard Chlorine of Delaware, Inc. v. Sinibaldi*, 821 F. Supp. 232 (D. Del. 1992). The "racketeering activity" alleged by the Plaintiffs, the predicate acts, are violations of the mail and wire fraud statutes, 18 U.S.C.A. §§ 1341, 1343.

Defendants argue that Plaintiffs have failed to allege a pattern of racketeering activity.[7] Plaintiffs seem to

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[7] As an aside, the Court notes that the Defendants have also argued that Plaintiffs have failed to allege or prove an enterprise within the meaning of RICO. "[A] RICO enterprise must exhibit three basic characteristics: (1) a common or shared purpose; (2) some continuity or structure and personnel; and (3) an ascertainable structure distinct from that inherent in a pattern of racketeering." *Atlas Pile Driving Co. v. DiCon*

have generally asserted that the mail and the wires were used to transmit information about yield spread premiums between lenders and brokers and to transmit fraudulent information about available interest rates between brokers and borrowers. The Court agrees with the Defendants that these general allegations are insufficient to support a civil RICO claim. Specifically, in order to succeed on a RICO claim predicated on mail or wire fraud, Plaintiff must prove the "existence of a plan or scheme to defraud." *United States v. Goodman*, 984 F.2d 235, 237 (8th Cir. 1993); *Demerath Land Company v. Sparr*, 48 F.3d 353, 355 (8th Cir. 1995). As a result, Plaintiffs must show that the Defendants formed some intent to defraud Plaintiffs or other similarly situated customers. The "'essence of a scheme is a plan to deceive persons as to the substantial identity of the things they are to receive in exchange.'" *United States v. Goodman*, 984 F.2d at 237 (citations omitted). Plaintiffs have offered no evidence that the Defendants intended to mislead the Defendants about what they were getting.[8] Indeed, all of the evidence indicates that Defendants complied fully with HUD's disclosure requirements and that the Plaintiffs were fully aware of the terms of the mortgage they were receiving.

Moreover, even if the Court were to determine that the overall scheme alleged by the Plaintiffs could meet

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Fin. Co., 886 F.2d 986, 995 (8th Cir. 1989). If the Court were to determine that summary judgment were inappropriate on the "pattern of racketeering activity" argument, the Court would decline to grant summary judgment on the basis of Defendants argument that there is no enterprise. The Court finds, rather, that Plaintiffs have set forth a sufficient basis for concluding that the Defendants were collectively engaged in an enterprise, distinct from any racketeering activity, which falls within the meaning of RICO. Specifically, the Defendants are two separate corporate entities which continue to be engaged in the ongoing enterprise of providing mortgages, an enterprise which includes the alleged racketeering activity, but which is distinct from it.

[8] It is perhaps relevant that there is no intent requirement to state a civil cause of action under RESPA. In that way, Plaintiffs RESPA's and RICO's claims are critically different.

the elements of mail and/or wire fraud, the Plaintiffs have failed to identify the particular communications which constitute the fraud. In the absence of such particularity in the pleadings, the Plaintiffs' claims must fail.

b. State Statutory Claims

Plaintiffs have asserted state statutory claims for deceptive trade practices pursuant to Minn. Stat. § 325D.44, Minn. Stat. § 325F.67, and the Michigan Consumer Protection Act. These statutory claims require that Plaintiffs make some showing of misrepresentation. As noted above, there is no question that the yield spread premiums were disclosed to the Plaintiffs and that the Plaintiffs fully understood the terms of the mortgage they obtained. While such disclosure by the Defendants and knowledge on the part of the Plaintiffs does not eliminate the possibility of liability under RESPA, it does eliminate the possibility of liability under the statutes cited.

c. Unjust Enrichment

As the Defendants note, unjust enrichment is an equitable claim that is not available when there is an adequate remedy at law. *Southtown Plumbing, Inc. v. Har-Ned Lumber Co.*, 493 N.W.2d 137, 140 (Minn. Ct. App. 1992). Plaintiffs have alleged no injury beyond that which would be adequately compensated by their RESPA claims, should those prove to be viable. In the event that the RESPA claims are not ultimately supported by the facts, as determined by a fact-finder, there would be no independent basis for recovery for unjust enrichment.

For the reasons stated, **IT IS HEREBY ORDERED**:

1. Plaintiffs' Renewed Motion for Class Certification (Doc. No. 65-2) is **GRANTED**;

2. Plaintiffs' Motion for Summary Judgment (Doc. No. 65-1) is **DENIED**; and

3. Defendant Standard Federal Bank's Motion for Summary Judgment (Doc. No. 72) is **GRANTED IN PART** and **DENIED IN PART** as follows:

a. With respect to Plaintiffs' claims under RESPA, the Motion is **DENIED**;

b. With respect to the remainder of Plaintiffs' claims (RICO, state statutory, and common law), the Motion is **GRANTED**.

Dated: March 22, 2000

/s/ DONOVAN W. FRANK

Donovan W. Frank
Judge of United States
District Court

APPENDIX E

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)

LONNIE GLOVER, DAWN GLOVER, AND
ALL OTHERS SIMILARLY SITUATED,
Plaintiffs,

v.

STANDARD FEDERAL BANK
AND HEARTLAND MORTGAGE,
Defendants.

[August 26, 1999]

MEMORANDUM OPINION AND ORDER

Introduction

The above-entitled matter came on for hearing before the undersigned United States District Judge on March 3, 1999, pursuant to Plaintiffs' Motion for Class Certification. In the Complaint, Plaintiffs allege violations of the anti-kickback and fee-splitting provisions of Section 8 of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607. For the reasons set forth below, Plaintiffs' motion for class certification is denied.

Background

Named Plaintiffs Lonnie and Dawn Glover acquired a mortgage for their home in the late 1980s. They refinanced their mortgage in 1990, 1993, and again in 1996. The 1996 refinancing is at issue here. In that instance, they moved from an adjustable rate mortgage to a fixed rate mortgage.

Defendant Heartland Mortgage ("Heartland") brokered the 1996 refinancing. Defendant Standard Federal Bank ("Standard Federal") is a lender which funded and acquired the 1996 mortgage; Standard Federal also services mortgages. Indeed, Standard Federal generally sells the mortgages which it funds and acquires from brokers to third parties, but typically retains the servicing rights on the mortgages.

In the instant case, pursuant to pricing sheets distributed by Standard Federal to the various brokers with which it does business, Heartland brokered a mortgage for the Plaintiffs with an "above par" interest rate and was subsequently paid a "yield spread premium" by Standard Federal. This yield spread premium is one focus of this dispute.

According to the Plaintiffs, the yield spread premium is tantamount to a kickback given to brokers for negotiating mortgages with interest rates which are disadvantageous to borrowers. The Real Estate Settlement Procedures Act (RESPA), 27 U.S.C. § 2601, et seq., states in pertinent part:

> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person. . . . No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.

27 U.S.C. §§ 2607(a) and 2607(b). According to the Plaintiffs, the yield spread premium – which is paid only for mortgages brokered at an "above par" interest rate and which varies based upon the interest rate itself and the amount of the mortgage – is a *per se* violation of RESPA. Specifically, they argue: (1) that the cost of

brokering a mortgage is not dependent on the interest rate obtained (i.e., it does not cost more to broker a higher interest mortgage); (2) the yield spread premiums are only paid for above-par interest rates; and (3) the mortgage broker is not selling the lender a more valuable mortgage because the broker never actually owns the mortgage.

Defendants, in contrast, assert that the yield spread premium is not a kickback at all but rather is part of an overall package of compensation to the broker for services provided by the broker. In support of their position, Defendants note that higher interest mortgages are not necessarily more valuable because many of them are paid off early or refinanced so the income stream and servicing fees from them is actually smaller. Furthermore, the yield spread premium is given to the broker in lieu of the borrower paying higher up-front costs (i.e., instead of the borrower paying a lot to the broker up front, the lender pays the broker the yield spread premium and eventually recovers this cost from the higher interest paid by the borrower). Finally, Defendants note that the Department of Housing and Urban Development ("HUD") (the agency which enforces RESPA) specifically provides guidelines for the disclosure of yield spread premiums, and HUD would not be likely to provide guidelines for the disclosure of an illegal practice. Defendants do not dispute that yield spread premiums can violate RESPA under some circumstances, but argue that the determination of whether a particular yield spread premium is a violation must be made on a case-by-case basis.

In addition to the yield spread premium for above-par interest rates, the Plaintiffs take issue with the following practices: (1) the payment of service release premiums for mortgages which assign the servicing rights to

Standard Federal[1]; (2) the payment of bonuses or "enhanced" yield spread premiums for brokered mortgages over $100,000[2]; (3) the payment of additional bonuses for new purchase loans (as opposed to refinancing), mortgages in choice geographic regions, and mortgages secured by "preferred brokers"; and (4) alleged fee splitting by Standard Federal in relation to underwriting and document preparation.[3]

Discussion

The sole issue before the Court is whether this case may appropriately be resolved through class action litigation. Rule 23(a) of the Federal Rules of Civil Procedure sets forth the threshold requirements for certification of a class:

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

In addition to these threshold requirements, a class action is only appropriate if one of the circumstances set forth in Rule 23(b) is present. The Plaintiffs here assert

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[1] According to Plaintiffs, these are referral fees. Again, Plaintiffs argue that the broker does not own any transferable right in the mortgage's servicing prior to closing. In other words, Standard Federal cannot be paying the brokers (here, Heartland) for a good – the servicing rights to the mortgage – because the good does not exist prior to the closing at which point it is instantaneously the property of Standard Federal.

[2] Again, Plaintiffs assert these are prohibited referral fees because the broker does not own the more valuable mortgage and the services required to broker a higher mortgage do not cost any more to provide.

[3] Plaintiffs contend that Standard Federal directly charges borrowers $200 for underwriting and $150 for document preparation even though it often contracts out these services to third-parties who are paid only a portion of these fees.

their motion for class certification based upon Rule 23(b)(3) which requires the Court to find "that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members. . . ."

Plaintiffs bear the burden of proof regarding the Rule 23 requirements. *In re Worker's Compensation*, 130 F.R.D. 99 (D. Minn. 1990). Nevertheless, to the extent there is a question regarding the appropriateness of certification, the presumption is in favor of certification. *Id.*

The Defendants challenge class certification on the issues of numerosity, typicality, representativeness of the named parties, and predominance of common question of law or fact. Because the Court concludes that Plaintiffs have not met their burden with respect to the 23(b)(3) requirement of predominance of common questions, the Court need not address the remaining factors of the certification standard.

The heart of Plaintiffs' claims, and the question which the purported class members allegedly have in common, is whether interest-based yield spread premiums and other payments based upon characteristics of the mortgage (described above) are illegal kickbacks or referral fees which violate RESPA. The Plaintiffs argue that resolution of this question will involve generalized evidence of the payment schedule employed by Standard Federal Bank. Defendants argue, instead, that any determination of the appropriateness under RESPA of lender to broker compensation involves a fact-specific, case by case inquiry, and is singularly unamenable to class-based litigation.

At the outset, the Court notes that the federal courts are experiencing an outbreak of litigation on the issue of yield spread premiums which has reached almost epidemic proportions. *See Yasgur v. Aegis Mortgage Corp.*, Civil No. 98-121 (JMR/FLN) (D. Minn. March 9, 1999) ("This kind of action seems to be the flavor of the month

at the copy-cat class action bar."). With each case filed, some federal district court is called upon to again revisit the question of whether such issues can best be resolved through class action litigation. Not surprisingly, there has been no clear consensus. *See, e.g., Mulligan v. Choice Mortgage Corp.*, 1998 WL 544431 (D. N.H. 1998) (granting class certification); *but see Conomos v. Chase Manhattan Corp.*, 1998 WL 118154 (S.D.N.Y. March 17, 1998) (denying class certification).

Until recently, the test for determining whether a payment by a lender to a broker constituted a violation of RESPA consisted of two steps. First, the fact finder was called upon to determine whether the payment was for a good or service rendered; if the payment was not associated with some good or service, then the payment violated RESPA. If the payment was associated with a good or service, then the fact-finder had to determine whether the payment was reasonable; if the payment was unreasonably high relative to the good or service associated with it, then the payment violated RESPA. *See, e.g., Culpepper v. Inland Mortgage Corp.*, 132 F.3d 692, 696-97 (11th Cir.), as modified, 144 F.3d 717 (1998); *Brancheau v. Residential Mortgage et al.*, 182 F.R.D. 579, 584-85 (D. Minn. 1998). Based upon that standard for assessing violations of RESPA, a number of courts granted class certification of these disputes. Specifically, these courts determined that generalized evidence regarding the fee schedules used by brokers and lenders could be used in the first step of the analysis. *See Brancheau*, 182 F.R.D. at 584.

In response to Congressional concern that the scope of RESPA was unclear, HUD issued a policy statement addressing, *inter alia*, the application of RESPA to yield spread premiums. Real Estate Settlement Procedures Act State of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers ("Policy Statement"), 64 Fed. Reg. 10080 (1999). The Policy Statement has been characterized as "not a model of clarity," *Levine v. North American Mortgage*, 1999 WL 454651, *6 (D. Minn.

1999); the description is apt. Essentially, HUD reaffirms that yield spread premiums are not *per se* violations of RESPA. Further, HUD articulates its own two-part test for analyzing particular payments under RESPA:

> In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

Policy Statement, 64 Fed. Reg. 10084. HUD later seems to elaborate upon the first prong of the test by stating that "the threshold question is whether there were goods or facilities actually furnished or services actually performed *for the total compensation paid* to the mortgage broker." *Id.* at 10085 (emphasis added).

The critical difference between the HUD test and the test previously defined by the courts is the stringency of the first prong. Where the courts required some showing that each element of compensation paid to a broker could be tied to a good or service provided, HUD apparently requires only that the broker provide some good or service, without any accounting for particular payments. *See Levine, supra*; *Schmitz v. Aegis Mortgage Corp.*, 48 F. Supp. 2d 877 (D. Minn. April 23, 1999).

The Court is somewhat troubled by this analysis of the requirements for RESPA. First, it is difficult to imagine the circumstances under which a broker will be involved in a mortgage transaction and yet provide no goods and render no services whatsoever; as a result, the first prong of the HUD-proposed analysis rings

hollow. Second, in *Culpepper et al. v. Inland Mortgage Corp.*, CV 96-BU-0917-S, CV 98-BU-2187-S (N.D. Ala. July 20, 1999) the district court noted that the HUD test (as construed by the majority of courts) gives rise to a potential inconsistency. Specifically, a lender could quite explicitly provide a kickback to a broker, but, under the "any services" and "total compensation" test, that kickback could actually be declared legal under the terms of RESPA if the broker happens to provide sufficient services to render the total compensation reasonable. In other words, regardless of the intent of the lender in giving money to the broker, the decision of whether the payment is illegal depends upon a whim of fate – whether, in the final analysis, the amount of money given to the broker *in toto* happens to be reasonable.

Nevertheless, the Court must defer to an agency's interpretation of a program within its administrative purview, unless the agency's interpretation is irrational, arbitrary, capricious, or in conflict with the plain language of the statute. *See generally Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-45 (1984). Here, the Court is faced with five decisions from this district alone which hold that the HUD Policy Statement articulates a test significantly less stringent than the test articulated by the Eleventh Circuit in *Culpepper* and that HUD's test is legitimate in light of the statutory language of RESPA. *See Kroskin, et al. v. Aggressive Mortgage Corp.*, Civil No. 98-600 (MJD/AJB) (D. Minn. July 12, 1999); *Brancheau v. Residential Mortgage, et al.*, 182 F.R.D. 579 (D. Minn. July 1, 1999); *Levine v. North American Mortgage*, 1999 WL 454651, ___ F. Supp. 2d ___ (D. Minn. July 1, 1999); *Schmitz v. Aegis Mortgage Corp.*, 48 F. Supp. 2d 877 (D. Minn. Apr. 23, 1999); *Yasgur v. Aegis Mortgage Corp.*, Civil No. 98-121 (JMR/FLN) (D. Minn. March 9, 1999); *see also McBride v. ReliaStar Mortgage v. Kingston Mortgage*, No. 1:98-CV-215-TWT (N.D. Ga. Apr. 19, 1999); *but see Culpepper, et al. v. Inland Mortgage*

Corp., CV 96-BU-0917-S, CV 98-BU-2187-S (N.D. Ala. July 20, 1999) (holding that the HUD Policy Statement does not alter the *Culpepper* two-step test and that class certification was appropriate); *Heimmermann v. First Union Mortgage Corp.*, 188 F.R.D. 403 (N.D. Ala. 1999) (same); *Dujanovic v. MortgageAmerica, Inc.*, 185 F.R.D. 660 (N.D. Ala. 1999) (not addressing the HUD Policy Statement, but granting class certification after issuance of the Policy Statement).

In the interest of insuring uniform application of the law, at least within the District of Minnesota, the Court adopts the analysis of the *Kroskin*, *Brancheau*, *Levine*, *Yasgur*, and *Schmitz* courts as a reasonable interpretation of RESPA and HUD's Policy Statement. Moreover, the Court is unwilling to find that the agency's Policy Statement, as interpreted by the Minnesota federal courts, is irrational, arbitrary, or contrary to law.

In the case before the Court, the Plaintiffs do not allege that Heartland Mortgage failed to provide any legitimate goods or services. Thus, the first step of the HUD test is satisfied. The second step of the test, determining whether the total compensation paid was reasonable in light of the goods and/or services provided, is a fact intensive inquiry which necessitates a case-by-case analysis. Accordingly, under the HUD test, class certification is inappropriate.

While the Court recognizes the reasonableness of the majority interpretation of the HUD Policy Statement, the Court is nevertheless troubled by the lack of clear authority and the resulting disagreement between district courts on a national level. The Eleventh Circuit has recently accepted an appeal of one of these yield spread premium cases (*McBride v. ReliaStar Mortgage Corp.*, No. 1:98-CV-215-TWT (N.D. GA. April 29, 1999) (order denying class certification)). The Court hopes that other appellate courts follow suit to provide greater certainty about this issue to courts and potential parties.

Moreover, the Court is concerned that the payment of yield spread premiums for high-interest mortgages appear, at least at first blush, to violate the spirit if not the letter of RESPA. While HUD's Policy Statement may be a reasonable interpretation of the law, it may ultimately frustrate the purpose of RESPA by creating too lax a standard for assessing violations. To the extent that HUD's Policy Statement leaves borrowers without adequate protection, the ball is squarely in Congress's court: if HUD's test undermines the spirit of RESPA, Congress must make that "spirit" explicit through legislation.

For the reasons stated, **IT IS HEREBY ORDERED**:

1. Plaintiff's Motion for Class Certification Doc. No. 27) is **DENIED**.

Dated: August 26th, 1999

/s/ DONOVAN W. FRANK

Donovan W. Frank
Judge of United States
District Court

APPENDIX F

Statutory Provisions

The Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. §§ 2601 *et seq.*, provides in pertinent part as follows:

12 U.S.C. § 2601. Congressional findings and purpose

(a) The Congress finds that significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. The Congress also finds that it has been over two years since the Secretary of Housing and Urban Development and the Administrator of Veterans' Affairs submitted their joint report to the Congress on "Mortgage Settlement Costs" and that the time has come for the recommendations for Federal legislative action made in that report to be implemented.

(b) It is the purpose of this chapter to effect certain changes in the settlement process for residential real estate that will result –

(1) in more effective advance disclosure to home buyers and sellers of settlement costs;

(2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;

(3) in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and

(4) in significant reform and modernization of local recordkeeping of land title information.

12 U.S.C. § 2602. Definitions

For purposes of this chapter –

(1) the term "federally related mortgage loan" includes any loan (other than temporary financing such as a construction loan) which –

(A) is secured by a first or subordinate lien on residential real property (including individual units of condominiums and cooperatives) designed principally for the occupancy of from one to four families, including any such secured loan, the proceeds of which are used to prepay or pay off an existing loan secured by the same property; and

(B)(i) is made in whole or in part by any lender the deposits or accounts of which are insured by any agency of the Federal Government, or is made in whole or in part by any lender which is regulated by any agency of the Federal Government; or

(ii) is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by the Secretary or any other officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary or a housing or related program administered by any other such officer or agency; or

(iii) is intended to be sold by the originating lender to the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or a financial institution from which it is to be purchased by the Federal Home Loan Mortgage Corporation; or

(iv) is made in whole or in part by any "creditor", as defined in section 1602(f) of title 15, who makes or invests in residential real estate loans aggregating more than $1,000,000 per year, except that for the purpose of this chapter, the term "creditor" does not include any agency or instrumentality of any State;

(2) the term "thing of value" includes any payment, advance, funds, loan, service, or other consideration;

(3) the term "Settlement services" includes any service provided in connection with a real estate settlement including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans), and the handling of the processing, and closing or settlement;

(4) the term "title company" means any institution which is qualified to issue title insurance, directly or through its agents, and also refers to any duly authorized agent of a title company;

(5) the term "person" includes individuals, corporations, associations, partnerships, and trusts;

(6) the term "Secretary" means the Secretary of Housing and Urban Development;

(7) the term "affiliated business arrangement" means an arrangement in which (A) a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent

in a provider of settlement services; and (B) either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider; and

(8) the term "associate" means one who has one or more of the following relationships with a person in a position to refer settlement business: (A) a spouse, parent, or child of such person; (B) a corporation or business entity that controls, is controlled by, or is under common control with such person; (C) an employer, officer, director, partner, franchisor, or franchisee of such person; or (D) anyone who has an agreement, arrangement, or understanding, with such person, the purpose or substantial effect of which is to enable the person in a position to refer settlement business to benefit financially from the referrals of such business.

12 U.S.C. § 2603. Uniform settlement statement

(a) The Secretary, in consultation with the Administrator of Veteran's Affairs, the Federal Deposit Insurance Corporation, and the Director of the Office of Thrift Supervision, shall develop and prescribe a standard form for the statement of settlement costs which shall be used (with such variations as may be necessary to reflect differences in legal and administrative requirements or practices in different areas of the country) as the standard real estate settlement form in all transactions in the United States which involve federally related mortgage loans. Such form shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement and shall indicate whether any title insurance premium included in such charges covers or insures the lender's interest in the property, the borrower's interest, or both. The Secretary may, by regulation, permit the deletion from the form prescribed under this section of items which are not, under local

laws or customs, applicable in any locality, except that such regulation shall require that the numerical code prescribed by the Secretary be retained in forms to be used in all localities. Nothing in this section may be construed to require that that part of the standard form which relates to the borrower's transaction be furnished to the seller, or to require that that part of the standard form which relates to the seller be furnished to the borrower.

(b) The form prescribed under this section shall be completed and made available for inspection by the borrower at or before settlement by the person conducting the settlement, except that (1) the Secretary may exempt from the requirements of this section settlements occurring in localities where the final settlement statement is not customarily provided at or before the date of settlement, or settlements where such requirements are impractical and (2) the borrower may, in accordance with regulations of the Secretary, waive his right to have the form made available at such time. Upon the request of the borrower to inspect the form prescribed under this section during the business day immediately preceding the day of settlement, the person who will conduct the settlement shall permit the borrower to inspect those items which are known to such person during such preceding day.

12 U.S.C. § 2607. Prohibition against kickbacks and unearned fees

(a) Business referrals

No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

(b) Splitting charges

No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.

(c) Fees, salaries, compensation, or other payments

Nothing in this section shall be construed as prohibiting (1) the payment of a fee (A) to attorneys at law for services actually rendered or (B) by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance or (C) by a lender to its duly appointed agent for services actually performed in the making of a loan, (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed, (3) payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers, (4) affiliated business arrangements so long as (A) a disclosure is made of the existence of such arrangement to the person being referred and, in connection with such referral, such person is provided a written estimate of the charge or range of charges generally made by the provider to which the person is referred (i) in the case of a face-to-face referral or a referral made in writing or by electronic media, at or before the time of the referral (and compliance with this requirement in such case may be evidenced by a notation in a written, electronic, or similar system of records maintained in the regular course of business); (ii) in the case of a referral made by telephone, within 3 business days after the referral by telephone, (and in such case an abbreviated verbal disclosure of the existence of the arrangement and the fact that a written disclosure will be provided within 3 business days shall be made to the person being referred during the telephone referral); or (iii) in the case of a

referral by a lender (including a referral by a lender to an affiliated lender), at the time the estimates required under section 2604(c) of this title are provided (notwithstanding clause (i) or (ii)); and any required written receipt of such disclosure (without regard to the manner of the disclosure under clause (i), (ii), or (iii)) may be obtained at the closing or settlement (except that a person making a face-to-face referral who provides the written disclosure at or before the time of the referral shall attempt to obtain any required written receipt of such disclosure at such time and if the person being referred chooses not to acknowledge the receipt of the disclosure at that time, that fact shall be noted in the written, electronic, or similar system of records maintained in the regular course of business by the person making the referral), (B) such person is not required to use any particular provider of settlement services, and (C) the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship, or (5) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture. For purposes of the preceding sentence, the following shall not be considered a violation of clause (4)(B): (i) any arrangement that requires a buyer, borrower, or seller to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender to represent the lender's interest in a real estate transaction, or (ii) any arrangement where an attorney or law firm represents a client in a real estate transaction and issues or arranges for the issuance of a policy of title insurance in the transaction directly as agent or through a separate corporate title insurance agency that may be established by that attorney or law firm and operated as an adjunct to his or its law practice.

(d) Penalties for violations; joint and several liability; treble damages; actions for injunction by Secretary and by State officials; costs and attorney fees; construction of State laws

(1) Any person or persons who violate the provisions of this section shall be fined not more than $10,000 or imprisoned for not more than one year, or both.

(2) Any person or persons who violate the prohibitions or limitations of this section shall be jointly and severally liable to the person or persons charged for the settlement service involved in the violation in an amount equal to three times the amount of any charge paid for such settlement service.

(3) No person or persons shall be liable for a violation of the provisions of subsection (c)(4)(A) of this section if such person or persons proves by a preponderance of the evidence that such violation was not intentional and resulted from a bona fide error notwithstanding maintenance of procedures that are reasonably adapted to avoid such error.

(4) The Secretary, the Attorney General of any State, or the insurance commissioner of any State may bring an action to enjoin violations of this section.

(5) In any private action brought pursuant to this subsection, the court may award to the prevailing party the court costs of the action together with reasonable attorneys fees.

(6) No provision of State law or regulation that imposes more stringent limitations on affiliated business arrangements shall be construed as being inconsistent with this section.

12 U.S.C. § 2614. Jurisdiction of courts; limitations

Any action pursuant to the provisions of section 2605, 2607, or 2608 of this title may be brought in the United States district court or in any other court of competent jurisdiction, for the district in which the property involved is located, or where the violation is alleged to have occurred, within 3 years in the case of a violation of section 2605 of this title and 1 year in the case of a violation of section 2607 or 2608 of this title from the date of the occurrence of the violation, except that actions brought by the Secretary, the Attorney General of any State, or the insurance commissioner of any State may be brought within 3 years from the date of the occurrence of the violation.

12 U.S.C. § 2617. Authority of Secretary

(a) Issuance of regulations; exemptions

The Secretary is authorized to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of this chapter.

(b) Liability for acts done in good faith in conformity with rule, regulation, or interpretation

No provision of this chapter or the laws of any State imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Secretary or the Attorney General, notwithstanding that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

(c) Investigations; hearings; failure to obey order; contempt

(1) The Secretary may investigate any facts, conditions, practices, or matters that may be deemed neces-

sary or proper to aid in the enforcement of the provisions of this chapter, in prescribing of rules and regulations thereunder, or in securing information to serve as a basis for recommending further legislation concerning real estate settlement practices. To aid in the investigations, the Secretary is authorized to hold such hearings, administer such oaths, and require by subpena the attendance and testimony of such witnesses and production of such documents as the Secretary deems advisable.

(2) Any district court of the United States within the jurisdiction of which an inquiry is carried on may, in the case of contumacy or refusal to obey a subpena of the Secretary issued under this section, issue an order requiring compliance therewith; and any failure to obey such order of the court may be punished by such court as a contempt thereof.

(d) Delay of effectiveness of recent final regulation relating to payments to employees

(1) In general

The amendment to part 3500 of title 24 of the Code of Federal Regulations contained in the final regulation prescribed by the Secretary and published in the Federal Register on June 7, 1996, which will, as of the effective date of such amendment –

(A) eliminate the exemption for payments by an employer to employees of such employer for referral activities which is currently codified as section 3500.14(g)(1)(vii) of such title 24; and

(B) replace such exemption with a more limited exemption in new clauses (vii), (viii), and (ix) of section 3500.14 of such title 24,

shall not take effect before July 31, 1997.

(2) Continuation of prior rule

The regulation codified as section 3500.14(g)(1)(vii) of title 24 of the Code of Federal Regulations, relating

to employer-employee payments, as in effect on May 1, 1996, shall remain in effect until the date the amendment referred to in paragraph (1) takes effect in accordance with such paragraph.

(3) Public notice of effective date

The Secretary shall provide public notice of the date on which the amendment referred to in paragraph (1) will take effect in accordance with such paragraph not less than 90 days and not more than 180 days before such effective date.

Regulatory Provisions

Regulation X, Part 3500 of Title 24 of the Code of Federal Regulations, provides in pertinent part as follows:

PART 3500–REAL ESTATE SETTLEMENT PROCEDURES ACT

24 C.F.R. § 3500.1 Designation.

This part may be referred to as Regulation X.

24 C.F.R. § 3500.2 Definitions.

(a) *Statutory terms.* All terms defined in RESPA (12 U.S.C. 2602) are used in accordance with their statutory meaning unless otherwise defined in paragraph (b) of this section or elsewhere in this part.

(b) *Other terms.* As used in this part:

Application means the submission of a borrower's financial information in anticipation of a credit decision, whether written or computer-generated, relating to a federally related mortgage loan. If the submission does not state or identify a specific property, the submission is an application for a pre-qualification and not an application for a federally related mortgage loan under this part. The subsequent addition of an identified property to the submission converts the submission to an application for a federally related mortgage loan.

Business day means a day on which the offices of the business entity are open to the public for carrying on substantially all of the entity's business functions.

Dealer means, in the case of property improvement loans, a seller, contractor, or supplier of goods or services. In the case of manufactured home loans, "dealer" means one who engages in the business of manufactured home retail sales.

Dealer loan or dealer consumer credit contract means, generally, any arrangement in which a dealer assists the borrower in obtaining a federally related mortgage loan from the funding lender and then assigns the dealer's legal interests to the funding lender and receives the net proceeds of the loan. The funding lender is the lender for the purposes of the disclosure requirements of this part. If a dealer is a "creditor" as defined under the definition of "federally related mortgage loan" in this part, the dealer is the lender for purposes of this part.

Effective date of transfer is defined in section 6(i)(1) of RESPA (12 U.S.C. 2605(i)(1)). In the case of a home equity conversion mortgage or reverse mortgage as referenced in this section, the effective date of transfer is the transfer date agreed upon by the transferee servicer and the transferor servicer.

Federally related mortgage loan or *mortgage loan* means as follows:

(1) Any loan (other than temporary financing, such as a construction loan):

(i) That is secured by a first or subordinate lien on residential real property, including a refinancing of any secured loan on residential real property upon which there is either:

(A) Located or, following settlement, will be constructed using proceeds of the loan, a structure or structures designed principally for occupancy of from one to four families (including individual units of condominiums and cooperatives and including any related interests, such as a share in the cooperative or right to occupancy of the unit); or

(B) Located or, following settlement, will be placed using proceeds of the loan, a manufactured home; and

(ii) For which one of the following paragraphs applies. The loan:

(A) Is made in whole or in part by any lender that is either regulated by or whose deposits or accounts are insured by any agency of the Federal Government;

(B) Is made in whole or in part, or is insured, guaranteed, supplemented, or assisted in any way:

(*1*) By the Secretary or any other officer or agency of the Federal Government; or

(*2*) Under or in connection with a housing or urban development program administered by the Secretary or a housing or related program administered by any other officer or agency of the Federal Government;

(C) Is intended to be sold by the originating lender to the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation (or its successors), or a financial institution from which the loan is to be purchased by the Federal Home Loan Mortgage Corporation (or its successors);

(D) Is made in whole or in part by a "creditor", as defined in section 103(f) of the Consumer Credit Protection Act (15 U.S.C. 1602(f)), that makes or invests in residential real estate loans aggregating more than $1,000,000 per year. For purposes of this definition, the term "creditor" does not include any agency or instrumentality of any State, and the term "residential real estate loan" means any loan secured by residential real property, including single-family and multifamily residential property;

(E) Is originated either by a dealer or, if the obligation is to be assigned to any maker of mortgage loans specified in paragraphs (1)(ii)(A) through (D) of this definition, by a mortgage broker; or

(F) Is the subject of a home equity conversion mortgage, also frequently called a "reverse mortgage," issued by any maker of mortgage loans specified in paragraphs (1)(ii) (A) through (D) of this definition.

(2) Any installment sales contract, land contract, or contract for deed on otherwise qualifying residential property is a federally related mortgage loan if the contract is funded in whole or in part by proceeds of a loan made by any maker of mortgage loans specified in paragraphs (1)(ii) (A) through (D) of this definition.

(3) If the residential real property securing a mortgage loan is not located in a State, the loan is not a federally related mortgage loan.

Good faith estimate means an estimate, prepared in accordance with section 5 of RESPA (12 U.S.C. 2604), of charges that a borrower is likely to incur in connection with a settlement.

HUD-1 or HUD-1A settlement statement (also *HUD-1* or *HUD-1A*) means the statement that is prescribed by the Secretary in this part for setting forth settlement charges in connection with either the purchase or the refinancing (or other subordinate lien transaction) of 1- to 4-family residential property.

Lender means, generally, the secured creditor or creditors named in the debt obligation and document creating the lien. For loans originated by a mortgage broker that closes a federally related mortgage loan in its own name in a table funding transaction, the lender is the person to whom the obligation is initially assigned at or after settlement. A lender, in connection with dealer loans, is the lender to whom the loan is assigned, unless the dealer meets the definition of creditor as defined under "federally related mortgage loan" in this section. See also § 3500.5(b)(7), secondary market transactions.

Managerial employee means an employee of a settlement service provider who does not routinely deal directly with consumers, and who either hires, directs, assigns, promotes, or rewards other employees or independent contractors, or is in a position to formulate, determine, or influence the policies of the employer. Neither the term "managerial employee" nor the term "employee" includes independent contractors, but a

managerial employee may hold a real estate brokerage or agency license.

Manufactured home is defined in § 3280.2 of this title.

Mortgage broker means a person (not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally related mortgage loan, and who renders services as described in the definition of "settlement services" in this section. A loan correspondent approved under § 202.8 of this title for Federal Housing Administration programs is a mortgage broker for purposes of this part.

Mortgaged property means the real property that is security for the federally related mortgage loan.

Person is defined in section 3(5) of RESPA (12 U.S.C. 2602(5)).

Public Guidance Documents means documents that HUD has published in the FEDERAL REGISTER, and that it may amend from time-to-time by publication in the FEDERAL REGISTER. These documents are also available from HUD at the address indicated in 24 CFR 3500.3.

Refinancing means a transaction in which an existing obligation that was subject to a secured lien on residential real property is satisfied and replaced by a new obligation undertaken by the same borrower and with the same or a new lender. The following shall not be treated as a refinancing, even when the existing obligation is satisfied and replaced by a new obligation with the same lender (this definition of "refinancing" as to transactions with the same lender is similar to Regulation Z, 12 CFR 226.20(a)):

(1) A renewal of a single payment obligation with no change in the original terms;

(2) A reduction in the annual percentage rate as computed under the Truth in Lending Act with a corresponding change in the payment schedule;

(3) An agreement involving a court proceeding;

(4) A workout agreement, in which a change in the payment schedule or change in collateral requirements is agreed to as a result of the consumer's default or delinquency, unless the rate is increased or the new amount financed exceeds the unpaid balance plus earned finance charges and premiums for continuation of allowable insurance; and

(5) The renewal of optional insurance purchased by the consumer that is added to an existing transaction, if disclosures relating to the initial purchase were provided.

Regulation Z means the regulations issued by the Board of Governors of the Federal Reserve System (12 CFR part 226) to implement the Federal Truth in Lending Act (15 U.S.C. 1601 *et seq.*), and includes the Commentary on Regulation Z.

Required use means a situation in which a person must use a particular provider of a settlement service in order to have access to some distinct service or property, and the person will pay for the settlement service of the particular provider or will pay a charge attributable, in whole or in part, to the settlement service. However, the offering of a package (or combination of settlement services) or the offering of discounts or rebates to consumers for the purchase of multiple settlement services does not constitute a required use. Any package or discount must be optional to the purchaser. The discount must be a true discount below the prices that are otherwise generally available, and must not be made up by higher costs elsewhere in the settlement process.

RESPA means the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. 2601 *et seq.*

Servicer means the person responsible for the servicing of a mortgage loan (including the person who makes or holds a mortgage loan if such person also services the mortgage loan). The term does not include:

(1) The Federal Deposit Insurance Corporation (FDIC) or the Resolution Trust Corporation (RTC), in connec-

tion with assets acquired, assigned, sold, or transferred pursuant to section 13(c) of the Federal Deposit Insurance Act or as receiver or conservator of an insured depository institution; and

(2) The Federal National Mortgage Corporation (FNMA); the Federal Home Loan Mortgage Corporation (Freddie Mac); the RTC; the FDIC; HUD, including the Government National Mortgage Association (GNMA) and the Federal Housing Administration (FHA) (including cases in which a mortgage insured under the National Housing Act (12 U.S.C. 1701 *et seq.*) is assigned to HUD); the National Credit Union Administration (NCUA); the Farmers Home Administration or its successor agency under Public Law 103-354 (FmHA); and the Department of Veterans Affairs (VA), in any case in which the assignment, sale, or transfer of the servicing of the mortgage loan is preceded by termination of the contract for servicing the loan for cause, commencement of proceedings for bankruptcy of the servicer, or commencement of proceedings by the FDIC or RTC for conservatorship or receivership of the servicer (or an entity by which the servicer is owned or controlled).

Servicing means receiving any scheduled periodic payments from a borrower pursuant to the terms of any mortgage loan, including amounts for escrow accounts under section 10 of RESPA (12 U.S.C. 2609), and making the payments to the owner of the loan or other third parties of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the mortgage servicing loan documents or servicing contract. In the case of a home equity conversion mortgage or reverse mortgage as referenced in this section, servicing includes making payments to the borrower.

Settlement means the process of executing legally binding documents regarding a lien on property that is subject to a federally related mortgage loan. This process may also be called "closing" or "escrow" in different jurisdictions.

Settlement service means any service provided in connection with a prospective or actual settlement, including, but not limited to, any one or more of the following:

(1) Origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of such loans);

(2) Rendering of services by a mortgage broker (including counseling, taking of applications, obtaining verifications and appraisals, and other loan processing and origination services, and communicating with the borrower and lender);

(3) Provision of any services related to the origination, processing or funding of a federally related mortgage loan;

(4) Provision of title services, including title searches, title examinations, abstract preparation, insurability determinations, and the issuance of title commitments and title insurance policies;

(5) Rendering of services by an attorney;

(6) Preparation of documents, including notarization, delivery, and recordation;

(7) Rendering of credit reports and appraisals;

(8) Rendering of inspections, including inspections required by applicable law or any inspections required by the sales contract or mortgage documents prior to transfer of title;

(9) Conducting of settlement by a settlement agent and any related services;

(10) Provision of services involving mortgage insurance;

(11) Provision of services involving hazard, flood, or other casualty insurance or homeowner's warranties;

(12) Provision of services involving mortgage life, disability, or similar insurance designed to pay a

mortgage loan upon disability or death of a borrower, but only if such insurance is required by the lender as a condition of the loan;

(13) Provision of services involving real property taxes or any other assessments or charges on the real property;

(14) Rendering of services by a real estate agent or real estate broker; and

(15) Provision of any other services for which a settlement service provider requires a borrower or seller to pay.

Special information booklet means the booklet prepared by the Secretary pursuant to section 5 of RESPA (12 U.S.C. 2604) to help persons understand the nature and costs of settlement services. The Secretary publishes the form of the special information booklet in the FEDERAL REGISTER. The Secretary may issue or approve additional booklets or alternative booklets by publication of a Notice in the FEDERAL REGISTER.

State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

Table funding means a settlement at which a loan is funded by a contemporaneous advance of loan funds and an assignment of the loan to the person advancing the funds. A table-funded transaction is not a secondary market transaction (see § 3500.5(b)(7)).

Title company means any institution, or its duly authorized agent, that is qualified to issue title insurance.

24 C.F.R. § 3500.4 Reliance upon rule, regulation or interpretation by HUD.

(a) *Rule, regulation or interpretation.* (1) For purposes of sections 19(a) and (b) of RESPA (12 U.S.C. 2617(a) and (b)) only the following constitute a rule, regulation or interpretation of the Secretary:

(i) All provisions, including appendices, of this part. Any other document referred to in this part is not incorporated in this part unless it is specifically set out in this part;

(ii) Any other document that is published in the FEDERAL REGISTER by the Secretary and states that it is an "interpretation," "interpretive rule," "commentary," or a "statement of policy" for purposes of section 19(a) of RESPA. Such documents will be prepared by HUD staff and counsel. Such documents may be revoked or amended by a subsequent document published in the FEDERAL REGISTER by the Secretary.

(2) A "rule, regulation, or interpretation thereof by the Secretary" for purposes of section 19(b) of RESPA (12 U.S.C. 2617(b)) shall not include the special information booklet prescribed by the Secretary or any other statement or issuance, whether oral or written, by an officer or representative of the Department of Housing and Urban Development (HUD), letter or memorandum by the Secretary, General Counsel, any Assistant Secretary or other officer or employee of HUD, preamble to a regulation or other issuance of HUD, Public Guidance Document, report to Congress, pleading, affidavit or other document in litigation, pamphlet, handbook, guide, telegraphic communication, explanation, instructions to forms, speech or other material of any nature which is not specifically included in paragraph (a)(1) of this section.

(b) *Unofficial interpretations; staff discretion.* In response to requests for interpretation of matters not adequately covered by this part or by an official interpretation issued under paragraph (a)(1)(ii) of this section, unofficial staff interpretations may be provided at the discretion of HUD staff or counsel. Written requests for such interpretations should be directed to the address indicated in § 3500.3. Such interpretations provide no protection under section 19(b) of RESPA (12 U.S.C. 2617(b)). Ordinarily, staff or counsel will not issue unofficial interpretations on matters adequately

covered by this part or by official interpretations or commentaries issued under paragraph (a)(1)(ii) of this section.

(c) All informal counsel's opinions and staff interpretations issued before November 2, 1992, were withdrawn as of that date. Courts and administrative agencies, however, may use previous opinions to determine the validity of conduct under the previous Regulation X.

24 C.F.R. § 3500.5 Coverage of RESPA.

(a) *Applicability.* RESPA and this part apply to all federally related mortgage loans, except for the exemptions provided in paragraph (b) of this section.

(b) *Exemptions.* (1) A loan on property of 25 acres or more.

(2) *Business purpose loans.* An extension of credit primarily for a business, commercial, or agricultural purpose, as defined by Regulation Z, 12 CFR 226.3(a)(1). Persons may rely on Regulation Z in determining whether the exemption applies.

(3) *Temporary financing.* Temporary financing, such as a construction loan. The exemption for temporary financing does not apply to a loan made to finance construction of 1- to 4-family residential property if the loan is used as, or may be converted to, permanent financing by the same lender or is used to finance transfer of title to the first user. If a lender issues a commitment for permanent financing, with or without conditions, the loan is covered by this part. Any construction loan for new or rehabilitated 1- to 4-family residential property, other than a loan to a bona fide builder (a person who regularly constructs 1- to 4-family residential structures for sale or lease), is subject to this part if its term is for two years or more. A "bridge loan" or "swing loan" in which a lender takes a security interest in otherwise covered 1- to 4- family residential property is not covered by RESPA and this part.

(4) *Vacant land.* Any loan secured by vacant or unimproved property, unless within two years from the date of the settlement of the loan, a structure or a manufactured home will be constructed or placed on the real property using the loan proceeds. If a loan for a structure or manufactured home to be placed on vacant or unimproved property will be secured by a lien on that property, the transaction is covered by this part.

(5) *Assumption without lender approval.* Any assumption in which the lender does not have the right expressly to approve a subsequent person as the borrower on an existing federally related mortgage loan. Any assumption in which the lender's permission is both required and obtained is covered by RESPA and this part, whether or not the lender charges a fee for the assumption.

(6) *Loan conversions.* Any conversion of a federally related mortgage loan to different terms that are consistent with provisions of the original mortgage instrument, as long as a new note is not required, even if the lender charges an additional fee for the conversion.

(7) *Secondary market transactions.* A *bona fide* transfer of a loan obligation in the secondary market is not covered by RESPA and this part, except as set forth in section 6 of RESPA (12 U.S.C. 2605) and § 3500.21. In determining what constitutes a *bona fide* transfer, HUD will consider the real source of funding and the real interest of the funding lender. Mortgage broker transactions that are table-funded are not secondary market transactions. Neither the creation of a dealer loan or dealer consumer credit contract, nor the first assignment of such loan or contract to a lender, is a secondary market transaction (see § 3500.2.)

24 C.F.R. § 3500.8 Use of HUD-1 or HUD-1A settlement statements.

(a) *Use by settlement agent.* The settlement agent shall use the HUD-1 settlement statement in every settlement involving a federally related mortgage loan in which there is a borrower and a seller. For transactions in which there is a borrower and no seller, such as refinancing loans or subordinate lien loans, the HUD-1 may be utilized by using the borrower's side of the HUD-1 statement. Alternatively, the form HUD-1A may be used for these transactions. Either the HUD-1 or the HUD-1A, as appropriate, shall be used for every RESPA-covered transaction, unless its use is specifically exempted, but the HUD-1 or HUD-1A may be modified as permitted under this part. The use of the HUD-1 or HUD-1A is exempted for open-end lines of credit (home-equity plans) covered by the Truth in Lending Act and Regulation Z.

(b) *Charges to be stated.* The settlement agent shall complete the HUD-1 or HUD-1A in accordance with the instructions set forth in appendix A to this part.

(c) *Aggregate accounting at settlement.* (1) After itemizing individual deposits in the 1000 series using single- item accounting, the servicer shall make an adjustment based on aggregate accounting. This adjustment equals the difference in the deposit required under aggregate accounting and the sum of the deposits required under single-item accounting. The computation steps for both accounting methods are set out in § 3500.17(d). The adjustment will always be a negative number or zero (-0-). The settlement agent shall enter the aggregate adjustment amount on a final line in the 1000 series of the HUD-1 or HUD-1A statement.

(2) During the phase-in period, as defined in § 3500.17(b), an alternative procedure is available. The settlement agent may initially calculate the 1000 series deposits for the HUD-1 and HUD-1A settlement statement using single-item analysis with only a one-month

cushion (unless the mortgage loan documents indicate a smaller amount). In the escrow account analysis conducted within 45 days of settlement, however, the servicer shall adjust the escrow account to reflect the aggregate accounting balance. Appendix E to this part sets out examples of aggregate analysis. Appendix A to this part contains instructions for completing the HUD-1 or HUD-1A settlement statements using an aggregate analysis adjustment and the alternative process during the phase-in period.

24 C.F.R. § 3500.14 Prohibition against kickbacks and unearned fees.

(a) *Section 8 violation.* Any violation of this section is a violation of section 8 of RESPA (12 U.S.C. 2607) and is subject to enforcement as such under § 3500.19.

(b) *No referral fees.* No person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. Any referral of a settlement service is not a compensable service, except as set forth in § 3500.14(g)(1). A company may not pay any other company or the employees of any other company for the referral of settlement service business.

(c) *No split of charges except for actual services performed.* No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibi-

tions of this part be avoided by creating an arrangement wherein the purchaser of services splits the fee.

(d) *Thing of value.* This term is broadly defined in section 3(2) of RESPA (12 U.S.C. 2602(2)). It includes, without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another person's expenses, or reduction in credit against an existing obligation. The term "payment" is used throughout §§ 3500.14 and 3500.15 as synonymous with the giving or receiving any "thing of value" and does not require transfer of money.

(e) *Agreement or understanding.* An agreement or understanding for the referral of business incident to or part of a settlement service need not be written or verbalized but may be established by a practice, pattern or course of conduct. When a thing of value is received repeatedly and is connected in any way with the volume or value of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business.

(f) *Referral.* (1) A referral includes any oral or written action directed to a person which has the effect of affirmatively influencing the selection by any person of a provider of a settlement service or business incident to or part of a settlement service when such person will pay for such settlement service or business incident thereto or pay a charge attributable in whole or in part to such settlement service or business.

(2) A referral also occurs whenever a person paying for a settlement service or business incident thereto is required to use (see § 3500.2, "required use") a particular provider of a settlement service or business incident thereto.

(g) *Fees, salaries, compensation, or other payments.* (1) Section 8 of RESPA permits:

(i) A payment to an attorney at law for services actually rendered;

(ii) A payment by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance;

(iii) A payment by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan;

(iv) A payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed;

(v) A payment pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and real estate brokers. (The statutory exemption restated in this paragraph refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity, and has no applicability to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.);

(vi) Normal promotional and educational activities that are not conditioned on the referral of business and that do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business incident thereto; or

(vii) An employer's payment to its own employees for any referral activities.

(2) The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee.

If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. The fact that the transfer of the thing of value does not result in an increase in any charge made by the person giving the thing of value is irrelevant in determining whether the act is prohibited.

(3) *Multiple services.* When a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person. For example, for an attorney of the buyer or seller to receive compensation as a title agent, the attorney must perform core title agent services (for which liability arises) separate from attorney services, including the evaluation of the title search to determine the insurability of the title, the clearance of underwriting objections, the actual issuance of the policy or policies on behalf of the title insurance company, and, where customary, issuance of the title commitment, and the conducting of the title search and closing.

(h) *Recordkeeping.* Any documents provided pursuant to this section shall be retained for five (5) years from the date of execution.

(i) *Appendix B of this part.* Illustrations in appendix B of this part demonstrate some of the requirements of this section.

EFFECTIVE DATE NOTE: At 61 FR 29252, June 7, 1996, § 3500.14 was amended by revising the last sentence of paragraph (b), the heading of paragraph (g), and paragraph (g)(1), effective Oct. 7, 1996. At 61 FR 51782, Oct. 4, 1996, the effective date was delayed until further notice. For the convenience of the user, the new text is set forth as follows:

§ 3500.14 Prohibition against kickbacks and unearned fees.

* * * * *

(b) * * * A business entity (whether or not in an affiliate relationship) may not pay any other business entity or the employees of any other business entity for the referral of settlement service business.

* * * * *

(g) *Exemptions for fees, salaries, compensation, or other payments.* (1) The following are permissible:

(i) A payment to an attorney at law for services actually rendered;

(ii) A payment by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance;

(iii) A payment by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan;

(iv) A payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed;

(v) A payment pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and real estate brokers. (The statutory exemption restated in this paragraph refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity, and has no applicability to any fee

arrangements between real estate brokers and mortgage brokers or between mortgage brokers.)

(vi) Normal promotional and educational activities that are not conditioned on the referral of business and do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business incident thereto;

(vii) A payment by an employer to its own *bona fide* employee for generating business for that employer;

(viii) In a controlled business arrangement, a payment by an employer of a bonus to a managerial employee based on criteria relating to performance (such as profitability, capture rate, or other thresholds) of a business entity in the controlled business arrangement. However, the amount of such bonus may not be calculated as a multiple of the number or value of referrals of settlement service business to a business entity in a controlled business arrangement; and

(ix)(A) A payment by an employer to its *bona fide* employee for the referral of settlement service business to a settlement service provider that has an affiliate relationship with the employer or in which the employer has a direct or beneficial ownership interest of more than 1 percent, if the following conditions are met:

(*1*) The employee does not perform settlement services in any transaction; and

(*2*) Before the referral, the employee provides to the person being referred a written disclosure in the format of the Controlled Business Arrangement Disclosure Statement, set forth in appendix D to this part.

(B) For purposes of this paragraph (g)(1)(ix), the marketing of a settlement service or product of an affiliated entity, including the collection and conveyance of information or the taking of an application or order for an affiliated entity, does not constitute the performance of a settlement service. Under this paragraph (g)(1)(ix), marketing of a settlement service or product may include incidental communications with the consumer after the application or order, such as providing the

consumer with information about the status of an application or order; marketing shall not include serving as the ongoing point of contact for coordinating the delivery and provision of settlement services.

* * * * *

24 C.F.R. § 3500.19 Enforcement.

(a) *Enforcement policy.* It is the policy of the Secretary regarding RESPA enforcement matters to cooperate with Federal, State or local agencies having supervisory powers over lenders or other persons with responsibilities under RESPA. Federal agencies with supervisory powers over lenders may use their powers to require compliance with RESPA. In addition, failure to comply with RESPA may be grounds for administrative action by the Secretary under part 24 of this title concerning debarment, suspension, ineligibility of contractors and grantees, or under part 25 of this title concerning the HUD Mortgagee Review Board. Nothing in this paragraph is a limitation on any other form of enforcement which may be legally available.

(b) *Violations of section 8 of RESPA (12 U.S.C. 2607), § 3500.14, or § 3500.15.* Any person who violates §§ 3500.14 or 3500.15 shall be deemed to violate section 8 of RESPA and shall be sanctioned accordingly.

(c) *Violations of section 9 of RESPA (12 U.S.C. 2608) or § 3500.16.* Any person who violates section 3500.16 of this part shall be deemed to violate section 9 of RESPA and shall be sanctioned accordingly.

(d) *Investigations.* The procedures for investigations and investigational proceedings are set forth in 24 CFR part 3800.

Federal Rules of Civil Procedure

Federal Rule of Civil Procedure 23 provides:

Rule 23. Class Actions

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members,

and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude the member from the class if the member so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if the member desires, enter an appearance through counsel.

(3) The judgment in an action maintained as a class action under subdivision (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class

action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16 , and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

(f) Appeals. A court of appeals may in its discretion permit an appeal from an order of a district court granting or denying class action certification under this rule if application is made to it within ten days after entry of the order. An appeal does not stay proceedings in the district court unless the district judge or the court of appeals so orders.

APPENDIX G

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR-4714-N-01]

RIN 2502-AH74

Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b)

AGENCY: Office of the Assistant Secretary for Housing – Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 2001-1

[October 18, 2001; 66 Fed. Reg. 53052]

SUMMARY: This Statement of Policy is being issued to eliminate any ambiguity concerning the Department's position with respect to those lender payments to mortgage brokers characterized as yield spread premiums and to overcharges by settlement service providers as a result of questions raised by two recent court decisions, *Culpepper v. Irwin Mortgage Corp.* and *Echevarria v. Chicago Title and Trust Co.*, respectively. In issuing this Statement of Policy, the Department clarifies its interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) in Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers (the 1999 Statement of Policy), and reiterates its long-standing interpretation of Section 8(b)'s prohibitions. *Culpepper v. Irwin Mortgage Corp.* involved the payment of yield spread premiums from lenders to mortgage brokers. *Echevarria v. Chicago Title and Trust Co.* involved the applicability of Section 8(b) to a

settlement service provider that overcharged a borrower for the service of another settlement service provider, and then retained the amount of the overcharge.

Today's Statement of Policy reiterates the Department's position that yield spread premiums are not per se legal or illegal, and clarifies the test for the legality of such payments set forth in HUD's 1999 Statement of Policy. As stated there, HUD's position that lender payments to mortgage brokers are not illegal per se does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The legality of yield spread premiums turns on the application of HUD's test in the 1999 Statement of Policy as clarified today.

The Department also reiterates its long-standing position that it may violate Section 8(b) and HUD's implementing regulations: (1) For two or more persons to split a fee for settlement services, any portion of which is unearned; or (2) for one settlement service provider to mark-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) for one settlement service provider to charge the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

This Statement of Policy also reiterates the importance of disclosure so that borrowers can choose the best loan for themselves, and it describes disclosures HUD considers best practices. The Secretary is also announcing that he intends to make full use of his regulatory authority to establish clear requirements for disclosure of mortgage broker fees and to improve the settlement process for lenders, mortgage brokers, and consumers.

EFFECTIVE DATE: October 18, 2001.

FOR FURTHER INFORMATION CONTACT: Ivy M. Jackson, Acting Director, RESPA/ILS Division, Room 9156, U.S. Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, DC 20410; telephone (202) 708-0502, or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/ RESPA, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone (202) 708-3137 (these are not toll-free numbers). Persons who have difficulty hearing or speaking may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:

General Background

The Department is issuing this Statement of Policy in accordance with 5 U.S.C. 552 as a formal pronouncement of its interpretation of relevant statutory and regulatory provisions. Section 19(a) (12 U.S.C. 2617(a)) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601-2617) (RESPA) specifically authorizes the Secretary "to prescribe such rules and regulations [and] to make such interpretations * * * as may be necessary to achieve the purposes of [RESPA]."

Section 8(a) of RESPA prohibits any person from giving and any person from accepting "any fee, kickback, or thing of value pursuant to an agreement or understanding, oral or otherwise" that real estate settlement service business shall be referred to any person. See 12 U.S.C. 2607(a). Section 8(b) prohibits anyone from giving or accepting "any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service * * * other than for services actually performed." 12 U.S.C. 2607(b). Section 8(c) of RESPA provides, "Nothing in [Section 8] shall be construed as prohibiting * * * (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for

services actually performed * * *" 12 U.S.C. 2607(c)(2). RESPA also requires the disclosure of settlement costs to consumers at the time of or soon after a borrower applies for a loan and again at the time of real estate settlement. 12 U.S.C. 2603-4. RESPA's requirements apply to transactions involving a "federally related mortgage loan" as that term is defined at 12 U.S.C. 2602(1).

I. Lender Payments to Mortgage Brokers

The Conference Report on the Department's 1999 Appropriations Act directed HUD to address the issue of lender payments to mortgage brokers under RESPA. The Conference Report stated that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. sec. 2607) in its enactment of RESPA." H. Rep. 105-769, at 260. As also directed by Congress, HUD worked with industry groups, federal agencies, consumer groups and other interested parties in collectively producing the 1999 Statement of Policy issued on March 1, 1999. 64 FR 10080. Interested members of the public are urged to consult the 1999 Statement of Policy for a more detailed discussion of the background on lender payments to brokers addressed in today's Statement.

HUD's 1999 Statement of Policy established a two-part test for determining the legality of lender payments to mortgage brokers for table funded transactions and intermediary transactions under RESPA: (1) Whether goods or facilities were actually furnished or services were actually performed for the compensation paid; and (2) whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to the goods, [*53053] facilities, or services furnished or performed to determine whether it

is legal under RESPA. In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker. Where a lender payment to a mortgage broker comprises a portion of total broker compensation, the amount of the payment is not, under the HUD test, scrutinized separately and apart from total broker compensation.

Since HUD issued its 1999 Statement of Policy, most courts have held that yield spread premiums from lenders to mortgage brokers are legal provided that such payments meet the test for legality articulated in the 1999 Statement of Policy and otherwise comport with RESPA. However, in a recent decision, *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001), the Court of Appeals for the Eleventh Circuit upheld certification of a class in a case alleging that yield spread premiums violated Section 8 of RESPA where the defendant lender, pursuant to a prior understanding with mortgage brokers, paid yield spread premiums to the brokers based solely on the brokers' delivery of above par interest rate loans. The court concluded that a jury could find that yield spread premiums were illegal kickbacks or referral fees under RESPA where the lender's payments were based exclusively on interest rate differentials reflected on rate sheets, and the lender had no knowledge of what services, if any, the broker performed. The court described HUD's 1999 Statement of Policy as "ambiguous." *Id.* at 1327. Accordingly, and because courts have now rendered conflicting decisions, HUD has an obligation to clarify its position and issues this Statement today to provide such clarification and certainty to lenders, brokers, and consumers.

Because this clarification focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is re-

stricted to payments to mortgage brokers in table funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exception.

II. Disclosure

Besides establishing the two-part test for determining the legality of yield spread premiums, the 1999 Statement of Policy discussed the importance of disclosure in permitting borrowers to choose the best loan for themselves. The mortgage transaction is complicated, and most people engage in such transactions relatively infrequently, compared to the other purchases they make. In some instances, borrowers have paid very large origination costs, either up front fees, yield spread premiums, or both, which they might have been able to avoid with timely disclosure. Timely disclosure would permit them to shop for preferable origination costs and mortgage terms and to agree to those costs and terms that meet their needs. The Department therefore is issuing a clarification of the importance of disclosure, with a description of disclosures that it considers to be best practices.

In this Statement of Policy, the Secretary is announcing that he intends to make full use of his regulatory authority as expeditiously as possible to provide clear requirements and guidance prospectively regarding disclosure of mortgage broker fees and, more broadly, to improve the mortgage settlement process so that homebuyers and homeowners are better served. Pending the promulgation of such a rule, the Secretary asks the industry to adopt new disclosure requirements to promote competition and to better serve consumers.

III. Unearned Fees

The 1999 Statement of Policy also touched upon another area of recurring questions under Section 8 of

RESPA: the legality of payments that are in excess of the reasonable value of the goods or facilities provided or services performed. See 64 FR 10082-3.

Since RESPA was enacted, HUD has consistently interpreted Section 8(b) and HUD's RESPA regulations to prohibit settlement service providers from charging unearned fees, as occurred in *Echevarria v. Chicago Title & Trust Co.*, 256 F.3d 623 (7th Cir. 2001). Such an interpretation is consistent with Congress's finding, when enacting RESPA, that consumers need protection from unnecessarily high settlement costs. Through this Statement of Policy, HUD makes clear that Section 8(b) prohibits any person from giving or accepting any fees other than payments for goods and facilities provided or services actually performed. Payments that are unearned fees occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In a July 5, 2001 decision, the Court of Appeals for the Seventh Circuit concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b). Accordingly, the court held that a settlement service provider did not violate Section 8(b) when, in billing a borrower, it added an overcharge to another provider's fees and retained the additional charge without providing any additional goods, facilities or services. *Echevarria v. Chicago Title & Trust Co.* Other courts have held that two or more parties must split or share a fee in order for a violation of Section 8(b) to occur. Still other courts have stated,

however, that a single provider can violate Section 8(b). Because the courts are now divided, HUD is issuing this Statement of Policy to reiterate its interpretation of Section 8(b).

The Court of Appeals for the Seventh Circuit rendered its conclusion in *Echevarria* "absent a formal commitment by HUD to an opposing position. * * *" Id. at 630. In issuing this Statement of Policy pursuant to Section 19(a), HUD reiterates its position on unearned fees under Section 8(b) of RESPA, which HUD regards as longstanding.

IV. Statement of Policy 2001-1

To give guidance to interested members of the real estate settlement industry and the general public on the application of RESPA and its implementing regulations, the Secretary hereby issues the following Statement of Policy. The interpretations embodied in this Statement of Policy are issued pursuant to Section 19(a) of RESPA. 12 U.S.C. 2617(a).

Part A. Mortgage Broker Fees

Yield Spread Premiums

One of the primary barriers to homeownership and homeowners' ability to refinance and lower their housing costs is the up front cash needed to obtain a mortgage. The closing costs and origination fees associated with a mortgage loan are a significant component of these up front [*53054] cash requirements. Borrowers may choose to pay these fees out of pocket, or to pay the origination fees, and possibly all the closing fees, by financing them; *i.e.*, adding the amount of such fees to the principal balance of their mortgage loan. The latter approach, however, is not available to those whose loan-to-value ratio has already reached the maximum permitted by the lender. For those without the available cash, who are at the maximum loan-to-value ratio, or who simply choose to do so, there is a third option. This third option is a yield spread premium.

Yield spread premiums permit homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate. Because the mortgage carries a higher interest rate, the lender is able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference. The payment allows the broker to recoup the up front costs incurred on the borrower's behalf in originating the loan. Payments from lenders to brokers based on the rates of borrowers' loans are characterized as "indirect" fees and are referred to as yield spread premiums.[1]

A yield spread premium is calculated based upon the difference between the interest rate at which the broker originates the loan and the par, or market, rate offered by a lender. The Department believes, and industry and consumers agree, that a yield spread premium can be a useful means to pay some or all of a borrower's settlement costs. In these cases, lender payments reduce the up front cash requirements to borrowers. In some cases, borrowers are able to obtain loans without paying any up front cash for the services required in connection with the origination of the loan. Instead, the fees for these services are financed through a higher interest rate on the loan. The yield spread premium thus can be a legitimate tool to assist the borrower. The availability of this option fosters homeownership.

HUD has recognized the utility of yield spread premiums in regulations issued prior to the 1999 Statement of Policy. In a final rule concerning "Deregulation of Mortgagor Income Requirements," HUD indicated that up front costs could be lowered by yield spread premiums. 54 FR 38646 (September 20, 1989).

In a 1992 rule concerning RESPA, HUD specifically listed yield spread premiums as an example of fees that must be disclosed. The example was codified as Illustra-

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[1] Indirect fees from lenders are also known as "back funded payments," "overages," or "servicing release premiums."

tions of Requirements of RESPA, Fact Situations 5 and 13 in Appendix B to 24 CFR part 3500. (See also Instructions at Appendix A to 24 CFR part 3500 for Completing HUD-1 and HUD-1A Settlement Statements.) HUD did not by these examples mean that yield spread premiums were *per se* legal, but HUD also did not mean that yield spread premiums were *per se* illegal.

HUD also recognizes, however, that in some cases less scrupulous brokers and lenders take advantage of the complexity of the settlement transaction and use yield spread premiums as a way to enhance the profitability of mortgage transactions without offering the borrower lower up front fees. In these cases, yield spread premiums serve to increase the borrower's interest rate and the broker's overall compensation, without lowering up front cash requirements for the borrower. As set forth in this Statement of Policy, such uses of yield spread premiums may result in total compensation in excess of what is reasonably related to the total value of the origination services provided by the broker, and fail to comply with the second part of HUD's two-part test as enunciated in the 1999 Statement of Policy, and with Section 8.

The 1999 Statement of Policy's Test for Legality

The Department restates its position that yield spread premiums are not per se illegal. HUD also reiterates that this statement "does not imply * * * that yield spread premiums are legal in individual cases or classes of transactions." 64 FR 10084. The legality of any yield spread premium can only be evaluated in the context of the test HUD established and the specific factual circumstances applicable to each transaction in which a yield spread premium is used.

The 1999 Statement of Policy established a two-part test for determining whether lender payments to mortgage brokers are legal under RESPA. In applying Section 8 and HUD's regulations, the 1999 Statement of Policy stated:

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (*i.e.*, yield spread premiums or any other class of named payments) to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases and classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets. 64 FR 10084.

Culpepper

The need for further clarification of HUD's position, as set forth in the 1999 Statement of Policy, on the treatment of lender payments to mortgage brokers under

Section 8 of RESPA (12 U.S.C. 2607), is evident from the recent decision of the Court of Appeals for the Eleventh Circuit in *Culpepper*.

In upholding class certification in *Culpepper*, the court only applied the first part of the HUD test, and then further narrowed its examination of whether the lender's yield spread payments were "for services" by focusing exclusively on the presumed intent of the lender in making the payments. The crux of the court's decision is that Section 8 liability for the payment of unlawful referral fees could be established under the first part of the HUD test alone, based on the facts that the lender's payments to mortgage brokers were calculated solely on the difference between the par interest rate and the higher rate at which the mortgage brokers delivered loans, and that the lender had no knowledge of what services, if any, the brokers had performed.

HUD was not a party to the case and disagrees with the judicial interpretation regarding Section 8 of [*53055] RESPA and the 1999 Statement of Policy.

Clarification of the HUD Test

It is HUD's position that where compensable services are performed, the 1999 Statement of Policy requires application of both parts of the HUD test before a determination can be made regarding the legality of a lender payment to a mortgage broker.

1. *The First Part of the HUD Test:* Under the first part of HUD's test, the total compensation to a mortgage broker, of which a yield spread premium may be a component or the entire amount, must be for goods or facilities provided or services performed. HUD's position is that in order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed by the broker in the transaction, whether the goods, facilities

or services are paid for by the borrower, the lender, or partly by both.

It is HUD's position that neither Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed. HUD considers the latter situation to be rare. The common industry practice is that lenders follow underwriting standards that demand a review of originations and that therefore lenders typically know that brokers have performed the services required to meet those standards.

Yield spread premiums are by definition derived from the interest rate. HUD believes that a rate sheet is merely a mechanism for displaying the yield spread premium, and does not indicate whether a particular yield spread premium is a payment for goods and facilities actually furnished or services actually performed under the HUD test. Whether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD's test applies to the transaction involved.

Section 8 prohibits the giving and accepting of fees, kickbacks, or things of value for the referral of settlement services and also unearned fees. It is therefore prudent for a lender to take action so as to ensure that brokers are performing compensable services and receiving only compensation that, in total, is reasonable for those services provided. As stated, however, in the 1999 Statement of Policy:

> The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible

> to identify or allocate which facilities, goods or services are performed or provided for the lender, for the borrower, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible. * * * 64 FR 10086.

The 1999 Statement of Policy provided a list of compensable loan origination services originally developed by HUD in a response to an inquiry from the Independent Bankers Association of America (IBAA), which HUD considers relevant in evaluating mortgage broker services. In analyzing each transaction to determine if services are performed HUD believes the 1999 Statement of Policy should be used as a guide. As stated there, the IBAA list is not exhaustive, and while technology is changing the process of performing settlement services, HUD believes that the list is still a generally accurate description of settlement services. Compensation for these services may be paid either by the borrower or by the lender, or partly by both. Compensable services for the first part of the test do not include referrals or no, nominal, or duplicative work.

2. *Reasonableness of Broker Fees:* The second part of HUD's test requires that total compensation to the mortgage broker be reasonably related to the total set of goods or facilities actually furnished or services performed.

The 1999 Statement of Policy said in part:

> The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. 64 FR 10084.

Accordingly, the Department believes that the second part of the test is applied by determining whether a mortgage broker's total compensation is reasonable. Total compensation includes fees paid by a borrower and any yield spread premium paid by a lender, not simply the yield spread premium alone. Yield spread premiums

serve to allow the borrower a lower up front cash payment in return for a higher interest rate, while allowing the broker to recoup the total costs of originating the loan. Total compensation to the broker must be reasonably related to the total value of goods or facilities provided or services performed by the broker. Simply delivering a loan with a higher interest rate is not a compensable service. The Department affirms the 1999 Statement of Policy's position on this matter for purposes of RESPA enforcement.

The 1999 Statement also said:

> In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with the amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. 64 FR 10086.

The 1999 Statement of Policy also stated:

> The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders. 64 FR 10081.

In evaluating mortgage broker fees for enforcement purposes, HUD will consider these factors as relevant in assessing the reasonableness of mortgage broker compensation, as well as comparing total compensation for

loans of similar size and similar characteristics within similar geographic markets.

Also, while the Department continues to believe that comparison to prices in similar markets is generally a key factor in determining whether a mortgage broker's total compensation is reasonable, it is also true that in less competitive markets comparisons to the prices charged by other similarly situated providers may not, standing alone, provide a useful measure. As a general principle, HUD believes that in evaluating the reasonableness of broker compensation in less competitive markets, consideration of price structures from a wider range of [*53056] providers may be warranted to reach a meaningful conclusion.

Part B. Providing Meaningful Information to Borrowers

In addition to addressing the legality of yield spread premiums in the 1999 Statement of Policy, HUD emphasized the importance of disclosing broker fees, including yield spread premiums.

> There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. 64 FR 10087.

HUD continues to believe that disclosure is extremely important, and that many of the concerns expressed by borrowers over yield spread premiums can be addressed by disclosing yield spread premiums, borrower compensation to the broker, and the terms of the mortgage loan, so that the borrower may evaluate and choose among alternative loan options.

In the 1999 Statement of Policy, HUD stated:

> * * * HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing

to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, pre-application disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. 64 FR 10087.

HUD currently requires the disclosure of yield spread premiums on the Good Faith Estimate and the HUD-1. The 1999 Statement of Policy said:

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like 'YSP to DBG, POC', for instance, have been noted. [Footnote omitted.] Also the Department has seen examples on the GFE and/or the settlement statement where the identity and/or purposes of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. 64 FR 10086-10087.

While the disclosure on the GFE and HUD-1 is required, the Department is aware and has stated that the current GFE/HUD-1 disclosure framework is often insufficient to adequately inform consumers about yield spread premiums and other lender paid fees to brokers. Under the current rules, the GFE need not be provided until after the consumer has applied for a mortgage and may have paid a significant fee, and the HUD-1 is only given at closing. Because of this, HUD has in recent years sought to foster a more consumer beneficial

approach to disclosure regarding yield spread premiums through successive rulemaking efforts. This history is discussed more fully in the 1999 Statement of Policy.[2]

Representatives of the mortgage industry have said that since the 1999 Statement of Policy, many brokers provide borrowers a disclosure describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from the lender. While the 1999 Statement of Policy commended the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting such a disclosure to their respective memberships, the Statement of Policy added:

> Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up the compensation. 64 FR 10087.

In HUD's view, meaningful disclosure includes many types of information: what services a mortgage broker will perform, the amount of the broker's total compensation for performing those services (including any yield spread premium paid by the lender), and whether or not the broker has an agency or fiduciary relationship with the borrower. The disclosure should also make the borrower aware that he or she may pay higher up front costs for a mortgage with a lower interest rate, or conversely pay a higher interest rate in return for lower

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[2] In both the HUD/Federal Reserve Board Report on RESPA/TILA Reform, 1998, and the HUD/Treasury Report on Curbing Predatory Home Mortgage Lending, 2000, the agencies recommended earlier disclosures to facilitate shopping and lower settlement costs.

up front costs, and should identify the specific trade-off between the amount of the increase in the borrower's monthly payment (and also the increase in the interest rate) and the amount by which up front costs are reduced. HUD believes that disclosure of this information, and written acknowledgment by the borrower that he or she has received the information, should be provided early in the transaction. Such disclosure facilitates comparison shopping by the borrower, to choose the best combination of up front costs and mortgage terms from his or her individual standpoint. HUD regards full disclosure and written acknowledgment by the borrower, at the earliest possible time, as a best practice.

Yield spread premiums are currently required to be listed in the "800" series of the HUD-1 form, listing "Items Payable in Connection with Loan." This existing practice, however, does not disclose the purpose of the yield spread premium, which is to lower up front cost to borrowers. To achieve this end it has been suggested to the Department that the yield spread premium should be reported as a credit to the borrower in the "200" series, among the "Amounts Paid by or in Behalf of Borrowers." The homebuyer or homeowner could then see that the yield spread premium is reducing closing costs, and also see the extent of the reduction.

HUD believes that improved early disclosure regarding mortgage broker compensation and the entry of yield spread premiums as credits to borrowers on the GFE and the HUD-1 settlement statement are both useful and complementary forms of disclosure. The Department believes that used together these methods of disclosure offer greater assurance that lender payments to mortgage brokers serve borrowers' best interests.

While the 1999 Policy Statement and IV. Part A. of this Statement only cover certain lender payments to mortgage brokers, as described above, HUD also believes that similar information on the trade-off between lower up front costs and higher interest rates and

monthly payments should be disclosed to borrowers on all mortgage loan originations, not merely those originated by brokers. HUD is aware that while yield spread premiums are not used in loans originated by lenders, lenders are able to offer loans with low or no up [*53057] front costs required at closing by charging higher interest rates and recouping the costs by selling the loans into the secondary market for a price representing the difference between the interest rate on the loan and the par, or market, interest rate. Sale of such a loan achieves the same purpose as the yield spread premium does on a loan originated by a broker. The Department strongly believes that all lenders and brokers should provide the level of consumer disclosure that the purposes of RESPA intend and that fair business practices demand. As indicated in the 1999 Statement of Policy, HUD emphasizes that fuller information provided as early as possible in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. In the future, full and early disclosures are factors that the Department would weigh favorably in exercising its enforcement discretion in cases involving mortgage broker fees. Nevertheless, the Department also again makes clear that disclosure alone does not make illegal fees legal under RESPA. The Department will scrutinize all relevant information in making enforcement decisions, including whether transactions evidence practices that may be illegal.

Part C. Section 8(b) Unearned Fees

A. Background

RESPA was enacted in 1974 to provide consumers "greater and more timely information on the nature of the costs of the [real estate] settlement process" and to protect consumers from "unnecessarily high settlement charges caused by certain abusive practices * * *" 12 U.S.C. 2601.

Since RESPA was enacted, HUD has interpreted Section 8(b) as prohibiting any person from giving or

accepting any unearned fees, i.e., charges or payments for real estate settlement services other than for goods or facilities provided or services performed. Payments that are unearned fees for settlement services occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In the first situation, two settlement service providers split or share a fee charged to a consumer and at least part, if not all, of at least one provider's share of the fee is unearned. In the second situation, a settlement service provider charges a fee to a consumer for another provider's services that is higher than the actual price of such services, and keeps the difference without performing any actual, necessary, and distinct services to justify the additional charge. In the third situation, one settlement service provider charges a fee to a consumer where no work is done or the fee exceeds the reasonable value of the services performed by that provider, and for this reason the fee or any portion thereof for which services are not performed is unearned.

HUD regards all of these situations as legally indistinguishable, in that they involve payments for settlement services where all or a portion of the fees are uearned and, thus, are violative of the statute. HUD, therefore, specifically interprets Section 8(b) as not being limited to situations where at least two persons split or share an unearned fee for the provision to be violated.

As already indicated in this Statement of Policy, meaningful disclosure of all charges and fees is essential

under RESPA. Such disclosures help protect consumers from paying unearned or duplicate fees. However, as noted above, in the 1999 Statement of Policy the Department reiterated "its long-standing view that disclosure alone does not make illegal fees legal under RESPA." 64 FR 10087.

B. HUD's Guidance and Regulations

HUD guidance and regulations have consistently interpreted Section 8 as prohibiting all unearned fees. In 1976, HUD issued a Settlement Costs Booklet that provided that "[i]t is also illegal to charge or accept a fee or part of a fee where no service has actually been performed." 41 FR 20289 (May 17, 1976). Between 1976 and 1992, HUD indicated in informal opinions that unearned fees occur where there are excessive fees charged, regardless of the number of settlement service providers involved.[3]

In the preamble to HUD's 1992 final rule revising Regulation X (57 FR 49600 (November 2, 1992)), HUD stated: "Section 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed (i.e., no payment of unearned fees)." 57 FR 49600 (November 2, 1992).

HUD's regulations, published on November 2, 1992, implement Section 8(b). Section 3500.14(c)[4] provides:

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[3] See e.g., Old Informal Opinion (6), August 16, 1976 and Old Informal Opinion (65), April 4, 1980; Barron and Berenson, *Federal Regulation of Real Estate and Mortgage Lending*, (4th Ed.1998). On November 2, 1992 (57 F.R. 49600), when HUD issued revisions to its RESPA regulations, it withdrew all of its informal counsel opinions and staff interpretations issued before that date. The 1992 rule provided, however, that courts and administrative agencies could use HUD's previous opinions to determine the validity of conduct occurring under the previous version of Regulation X. *See* 24 CFR 3500.4(c).

[4] The heading to 24 CFR 3500.14 is titled "Prohibition against kickbacks and unearned fees." However, the heading of subsection (c) is titled "split of charges," and the preamble to the November 1992 rule

No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally-related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this part be avoided by creating an arrangement wherein the purchaser of services splits the fee.

24 CFR 3500.14(g)(2) states in part:

The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of Section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation.

24 CFR 3500.14(g)(3) provides in part:

When a person in a position to refer settlement service business *** receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person. [*53058]

In Appendix B to the HUD RESPA regulations, HUD provides illustrations of the requirements of RESPA. Comment 3 states in part:

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states "[s]ection 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed (i.e., no payment of unearned fees)." 57 FR 49600 (November 2, 1992). The rule headings and preamble text are a generalized description of Section 8 that is more developed in the actual regulation text. As discussed in Section D of this Statement of Policy, HUD believes that the actual text of the rules, as amended in 1992, makes clear that Section 8(b)' s prohibitions ag. inst unearned fees apply even when only one settlement service provider is involved.

> The payment of a commission or portion of the * * * premium * * * or receipt of a portion of the payment * * * where no substantial services are being performed * * * is a violation of Section 8 of RESPA. It makes no difference whether the payment comes from [the settlement service provider] or the purchaser. The amount of the payment must bear a reasonable relationship to the services rendered. Here [the real estate broker in the example] is being compensated for a referral of business to [the title company].

In 1996, in the preamble to the final rule on the Withdrawal of Employer/Employee and Computer Loan Origination Systems Exemptions[5] (61 FR 29238 (June 7, 1996)), HUD reiterated its interpretation of Section 8(b) of RESPA as follows:

> HUD believes that Section 8(b) of the statute and the legislative history make clear that no person is allowed to receive 'any portion' of charges for settlement services, except for services actually performed. The provisions of Section 8(b) could apply in a number of situations: (1) where one settlement service provider receives an unearned fee from another provider; (2) where one settlement service provider charges the consumer for third-party services and retains an unearned fee from the payment received; or (3) where one settlement service provider accepts a portion of a charge (including 100% of the charge) for other than services actually performed. The interpretation urged [by the commenters to the proposed rule published on July 21, 1994], that a single settlement service provider can charge unearned or excessive fees so long as the fees are not shared with another, is an unnecessarily restrictive interpretation of a statute designed to reduce unnecessary costs to consumers. The Secretary, charged by statute with interpreting RESPA, interprets Section 8(b) to mean that two persons are not required for the provision to be violated. 61 FR 29249.

The latest revision to the Settlement Costs Booklet for consumers, issued in 1997, also provides "[i]t is also illegal for anyone to accept a fee or part of a fee for services if that person has not actually performed settlement services for the fee." 62 FR 31998 (June 11, 1997).

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[5] This final rule was delayed by legislation, but the Department implemented portions of the final rule that were not affected by the legislative delay on November 15, 1996. 61 FR 58472 (November 15, 1996).

Further, HUD has provided information to the public and the mortgage industry in the "Frequently Asked Questions" section of its RESPA Web site, located at <*http://www.hud.gov/fha/sfh/res/resindus.html*>. Question 25 states:

> Can a lender collect from the borrower an appraisal fee of $200, listing the fee as such on the HUD-1, yet pay an independent appraiser $175 and collect the $25 difference?

The answer reads:

> No, the lender may only collect $175 as the actual charge. It is a violation of Section 8(b) for any person to accept a split of a fee where services are not performed.

In 1999, by letter submitted at the request of the Superior Court of California, Los Angeles County, in the case of *Brown v. Washington Mutual Bank* (Case No. BC192874), HUD provided the following response to a specific question posed by the court on lender "markups" of another settlement service provider's fees:

> A lender that purchases third party vendor services for purposes of closing a federally related mortgage loan may not, under RESPA, mark up the third party vendor fees for purposes of making a profit. HUD has consistently advised that where lenders or others charge consumers marked-up prices for services performed by the third party providers without performing additional services, such charges constitute "splits of fees" or "unearned fees" in violation of Section 8(b) of RESPA.

HUD noted in its letter to the court that the response reflected the Department's long-standing position.

C. Recent Cases

Notwithstanding HUD's regulations and other guidance, the Court of Appeals for the Seventh Circuit held, in *Echevarria v. Chicago Title and Trust Co.*, 256 F.3d 623 (7th Cir. 2001), that Section 8(b) was not violated where a title company, without performing any additional services, charged the plaintiffs more money than was required by the recorder's office to record a deed and the title company then retained the difference. The

court reasoned that plaintiffs "failed to plead facts tending to show that Chicago Title illegally shared fees with the Cook County Recorder. The Cook County Recorder received no more than its regular recording fees and it did not give to or arrange for Chicago Title to receive an unearned portion of these fees. The County Recorder has not engaged in the third party involvement necessary to state a claim under [RESPA § 8(b)]." Id. at 626. The court in essence concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b).

Earlier, in *Willis v. Quality Mortgage USA, Inc.*, 5 F. Supp. 2d 1306 (M.D. Ala. 1998), cited by the Seventh Circuit in support of its conclusion, the district court concluded that 24 CFR 3500.14(c), "[w]hen read as a whole," prohibits payments for which no services are performed "only if those payments are split with another party." Id. at 1309. The *Willis* court held that there must be a split of a charge between a settlement service provider and a third party to establish a violation Section 8(b). The court also concluded that 24 CFR 3500.14(g)(3) only applied when there was a payment from a lender to a broker, or vice versa. The payment from a borrower to a mortgage lender could not be the basis for a violation of 24 CFR 3500.14(g)(3) and Section 8(b).

HUD was not a party to the cases and disagrees with these judicial interpretations of Section 8(b) which it regards as inconsistent with HUD's regulations and HUD's long-standing interpretations of Section 8(b).

D. Unearned Fees Under Section 8(b)

This Statement of Policy reaffirms HUD's existing, long-standing interpretation of Section 8(b) of RESPA. Sections 8(a) and (b) of RESPA contain distinct prohibitions. Section 8(a) prohibits the giving or acceptance of any payment pursuant to an agreement or understanding for the referral of settlement service business involving a federally related mortgage loan; it is intended to eliminate kickbacks or compensated referral arrange-

ments among settlement service providers. Section 8(b) prohibits the giving or accepting of any portion, split, or percentage of any charge other than for goods or facilities provided or services performed; it is intended to eliminate unearned fees. Such fees are contrary to the Congressional finding when enacting RESPA that consumers need protection from unnecessarily high settlement charges. 12 U.S.C. 2601(a).

It is HUD's position that Section 8(b) proscribes the acceptance of any portion or part of a charge other than for services actually performed. Inasmuch as Section 8(b)'s proscription against "any portion, split, or percentage" of an unearned charge for settlement services is written in the disjunctive, the prohibition is not limited to a split. In HUD's view, Section 8(b) forbids the paying or accepting of any portion or percentage of a settlement service – including up to 100% – that is unearned, whether the entire charge is divided or split among more than one person or entity or is retained by a single person. Simply put, given that Section 8(b) proscribes unearned portions or percentages as well as splits, HUD does not regard the provision as restricting only fee splitting among settlement service providers. Further, since Section 8(b) on its face prohibits [*53059] the giving or accepting of an unearned fee by any person, and 24 CFR 3500.14(c) speaks of a charge by "a person," it is also incorrect to conclude that the Section 8(b) proscription covers only payments or charges among settlement service providers.[6]

A settlement service provider may not levy an additional charge upon a borrower for another settlement service provider's services without providing additional services that are bona fide and justify the increased charge. Accordingly, a settlement service provider may not mark-up the cost of another provider's services without providing additional settlement services; such pay-

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[6] HUD is, of course, unlikely to direct any enforcement actions against consumers for the payment of unearned fees, because a consumer's intent is to make payment for services, not an unearned fee.

ment must be for services that are actual, necessary and distinct services provided to justify the charge. 24 CFR 3500.14(g)(3).[7] The HUD regulation implementing Section 8(b) states: "[a] charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section." 24 CFR 3500.14 (c).

The regulations also make clear that a charge by a single service provider where little or no services are performed is an unearned fee that is prohibited by the statute. 24 CFR 3000.14(c). A single service provider is also prohibited from charging a duplicative fee. Further, a single service provider cannot serve in two capacities, e.g., a title agent and closing attorney, and be paid twice for the same service. The fee the service provider would be receiving in this case is duplicative under 24 CFR 3000.14(c) and not necessary and distinct under 24 CFR 3000.14(g)(3). Clearly, in all of these instances, the source of the payment – whether from consumers, other settlement service providers, or other third parties – is not relevant in determining whether the fee is earned or unearned because ultimately, all settlement payments come directly or indirectly from the consumer. See 24 CFR 3500.14(c). Therefore, a single settlement service provider violates Section 8(b) whenever it receives an unearned fee.

A single service provider also may be liable under Section 8(b) when it charges a fee that exceeds the reasonable value of goods, facilities, or services provided. HUD's regulations as noted state: "If the payment of a thing of value bears no relationship to the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 CFR 3500.14(g)(2). Section 8(c)(2) only allows "the payment to any person of a bona fide salary or compensation or

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[7] HUD notes that some lenders have charged an additional fee merely for "reviewing" another settlement service provider's services. HUD does not regard such "review" as constituting an actual, necessary, or distinct additional service permissible under HUD's regulations.

other payment for goods or facilities actually furnished or services actually performed," i.e., permitting only that compensation which is reasonably related to the goods or facilities provided or services performed. Compensation that is unreasonable is unearned under Section 8(b) and is not bona fide under Section 8(c)(2).

The Secretary, therefore, interprets Section 8(b) of RESPA to prohibit all unearned fees, including, but not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

V. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) has reviewed this Statement of Policy in accordance with Executive Order 12866, (captioned "Regulatory Planning and Review"). OMB determined that this Statement of Policy is a "significant regulatory action" as defined in Section 3(f) of the Order (although not an economically significant regulatory action under the Order). Any changes to the Statement of Policy resulting from this review are available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk.

Dated: October 15, 2001.

John C. Weicher,

Assistant Secretary for Housing – Federal Housing Commissioner.

APPENDIX H

[seal omitted]

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

September 11, 2000

The Honorable Janice D. Schakowsky
U.S. House of Representatives
Washington, DC 20515-1309

Dear Representative Schakowsky:

Thank you for your letter dated July 17, 2000 to the Secretary urging the Department to file an amicus brief in the Eleventh Circuit Court of Appeals in *Heimmerman* v. *First Union Mortgage Corporation*. In light of your assertion that the Mortgage Bankers Association has submitted a brief to the court seeking an interpretation of HUD's March 1, 1999 Statement of Policy on Lender Payments to Mortgage Brokers ("Statement of Policy" or "Statement") which is actually contrary to the Statement, we are reviewing the pleadings in this case.

Without prejudging the outcome of the review, however, I do want to emphasize that HUD generally believes the Statement of Policy to be a clear interpretation of the applicability of Section 8 of the Real Estate Settlement Procedures Act (RESPA) to mortgage broker compensation that can be relied on by the public. Section 8(a) of RESPA prohibits the giving or receiving of "any fee, kickback, or thing of value pursuant to any agreement or understanding" that settlement service business will be referred to any person. Section 8(b) prohibits the acceptance of any "portion, split, or percentage of any charge . . . other than for services actually performed." Section 8(c) makes it clear, however,

that nothing in the Section prohibits the payment to any person of bona fide compensation for goods or facilities actually furnished or for services actually performed.

The Statement of Policy resulted from a directive in the Conference Report on HUD's 1999 Appropriations Act that HUD clarify its position on lender payments to mortgage brokers within 90 days after the enactment of the law. The Report further stated that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of Section 8(a) or (b) of RESPA." The Report also expressed concern "about the legal uncertainty that continues absent such a policy statement."

In the Statement the Department confirmed its long held view that so-called "yield spread premiums" are neither legal or illegal *per se*. The Statement of Policy articulates a two-part test to determine the legality of yield spread or other payments to mortgage brokers from lenders. HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for" — i.e., in exchange for — the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker. In applying this test, HUD believes a broker's total compensation should be scrutinized. The Statement goes on to make clear that "[t]otal compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all." 64 Fed. Reg. 10084.

On December 17, 1999 I responded to a number of questions submitted by Representative Vento in a December 7, 1999 letter which he wrote to me regarding the Statement of Policy. In that response I made clear that (1) the Statement was not intended to create new

law or establish a new legal standard; (2) HUD does not consider lender payments to mortgage brokers illegal *per se*; and (3) HUD did not intend the Statement to weaken the prohibitions contained in section 8 of RESPA, but rather, "by elucidating the tests for when fees could be legal, sought to establish a brighter line defining illegal conduct." A copy of that letter is enclosed.

Again, thank you for your interest in the Statement of Policy, and your extensive and tireless efforts to combat predatory lending. The Secretary and I share your commitment to do everything possible to eradicate all forms of abusive mortgage lending practices.

Sincerely,

/s/ Gail W. Laster

Gail W. Laster
General Counsel

Enclosure [omitted]

APPENDIX I

[seal omitted]

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

March 21, 2000

The Honorable Richard Shelby
United States Senate
Washington, D.C. 20510-0103

Dear Senator Shelby:

I regret the delay in responding to your letter dated November 19, 1999. In this response we answer three questions from your constituent, Mr. Leonard V. Zumpano, Director of the Alabama Research and Education Center at the University of Alabama, regarding lender payments to mortgage brokers under the Real Estate Settlement Procedures Act (RESPA). Specifically, Mr. Zumpano asks: (1) whether HUD intended for its recent Statement of Policy on this subject to create a new legal standard or to change existing law; (2) whether in order to be legal under RESPA, lender payments must be paid in exchange for goods, facilities or services actually provided by the broker, or whether "reasonable" payments are legal regardless of the purpose of the fees; and (3) whether HUD intends for its Policy Statement to weaken the referral fee prohibitions contained in RESPA.

Regarding the first question, as requested in the Conference Report on the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769), on March 1, 1999, HUD issued Statement of Policy 1999-1 regarding the legality of mortgage lender

payments to mortgage brokers under RESPA. The preamble to the Statement of Policy expressly states that it "provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law." 64 Fed.Reg. 10084. In accordance with its express language, HUD did not intend for the Policy Statement to create a new legal standard or to change existing law.

As to the second question, the Policy Statement makes clear that HUD does not consider lender payments to mortgage brokers illegal *per se*. The Policy Statement articulates a two-part test to determine the legality of yield spread or other payments to mortgage brokers from lenders. HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for" – i.e., in exchange for – the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker. 64 Fed.Reg. 10084. Regarding the first test, the Policy Statement sets out the minimum types and extent of services that a mortgage broker must perform in order to justify compensation to the broker. The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed.Reg. 10085-6. Accordingly, the mere performance of any service by a mortgage broker is not in itself sufficient to establish that the payment to the broker was made in exchange for those services. "The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." 64 Fed.Reg. 10086. In applying this second test, the total compensation from the lender and the borrower should be scrutinized to assure that the payment is reasonably related to goods, facilities, or services furnished or per-

formed. 64 Fed.Reg. 10084 and 10086. Moreover, the Policy Statement also makes clear that in analyzing whether any transaction under RESPA and its regulations involves compensation for "goods," a mortgage loan is not a "good," and that the referral of a loan is not a compensable service. 64 Fed. Reg. 10085 and 10086. HUD stated that mortgage brokers and lenders could better demonstrate the reasonableness of mortgage broker compensation if, at the time a consumer first discusses the possibility of a loan with a broker, the broker discloses the nature of its services and the various methods of its compensation. At a minimum, mortgage brokers are required to clearly label and properly estimate their fees on the Good Faith Estimates. 64 Fed.Reg. 10087.

Finally, the preamble to the Policy Statement affirms that "[t]he Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers." 64 Fed.Reg. 10082. Moreover, it says that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." 64 Fed.Reg. 10084. HUD, therefore, never intended for its Policy Statement to weaken the prohibitions contained in Section 8 of RESPA and indeed, in elucidating the tests for when fees could be legal, sought to establish a brighter line defining illegal conduct. HUD is committed to assuring that consumers receive all of the protections that Congress afforded under RESPA.

I appreciate your interest in the Department's programs. If I can be of further assistance, please contact me.

Sincerely,

/s/ Gail W. Laster

Gail W. Laster
General Counsel

APPENDIX J

[seal omitted]

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

December 17, 1999

The Honorable Bruce F. Vento
U.S. House of Representatives
Washington, DC 20515-2304

Dear Representative Vento:

This is in response to your letter dated December 7, 1999, asking three questions on behalf of your constituents regarding lender payments to mortgage brokers under the Real Estate Settlement Procedures Act (RESPA). Specifically, you ask: (1) whether, in its Statement of Policy 1999-1 (64 Fed.Reg. 10084), HUD intended to change existing law and create a new, less stringent legal standard; (2) what factors HUD examines in determining whether payments to mortgage brokers are legal under RESPA; and (3) whether HUD intended the Policy Statement to weaken the referral fee prohibitions contained in RESPA.

Regarding the first question, as requested in the Conference Report on the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769), on March 1, 1999, HUD issued Statement of Policy 1999-1 regarding the legality of mortgage lender payments to mortgage brokers under RESPA. The preamble to the Statement of Policy expressly states that it "provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law." 64 Fed.Reg. 10084. In accordance with its express language, HUD

did not intend for the Policy Statement to create a new legal standard or to change existing law.

As to the second question, the Policy Statement makes clear that HUD does not consider lender payments to mortgage brokers illegal *per se*. The Policy Statement articulates a two-part test to determine the legality of yield spread or other payments to mortgage brokers from lenders. HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for" – i.e., in exchange for – the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker. 64 Fed.Reg. 10084. Regarding the first test, the Policy Statement sets out the minimum types and extent of services that a mortgage broker must perform in order to justify compensation to the broker. The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed.Reg. 10085-6. Accordingly, the mere performance of any service by a mortgage broker is not in itself sufficient to establish that the payment to the broker was made in exchange for those services. "The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." 64 Fed.Reg. 10086. In applying this second test, the total compensation from the lender and the borrower should be scrutinized to assure that the payment is reasonably related to goods, facilities, or services furnished or performed. 64 Fed.Reg. 10084 and 10086. Moreover, the Policy Statement also makes clear that in analyzing whether any transaction under RESPA and its regulations involves compensation for "goods," a mortgage loan is not a "good," and that the referral of a loan is not a

compensable service. 64 Fed. Reg. 10085 and 10086. HUD stated that mortgage brokers and lenders could better demonstrate the reasonableness of mortgage broker compensation if, at the time a consumer first discusses the possibility of a loan with a broker, the broker discloses the nature of its services and the various methods of its compensation. At a minimum, mortgage brokers are required to clearly label and properly estimate their fees on the Good Faith Estimates. 64 Fed. Reg. 10087.

Finally, the preamble to the Policy Statement affirms that "[t]he Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers." 64 Fed.Reg. 10082. Moreover, it says that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." 64 Fed.Reg. 10084. HUD, therefore, never intended for its Policy Statement to weaken the prohibitions contained in Section 8 of RESPA and indeed, in elucidating the tests for when fees could be legal, sought to establish a brighter line defining illegal conduct. HUD is committed to assuring that consumers receive all of the protections that Congress afforded under RESPA.

I appreciate your interest in the Department's programs. If I can be of further assistance, please contact me.

Sincerely,

/s/ Gail W. Laster

Gail W. Laster
General Counsel

APPENDIX K

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR-4450-N-01]

RIN 2502-AH33

Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers

AGENCY: Office of the Assistant Secretary for Housing – Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 1999-1

[March 1, 1999; 64 Fed. Reg. 10080]

SUMMARY: This Statement of Policy sets forth the Department of Housing and Urban Development's position on the legality of lender payments to mortgage brokers in connection with federally related mortgage loans under the Real Estate Settlement Procedures Act ("RESPA") and HUD's implementing regulations. While this statement satisfies the Conferees' directive in the Conference Report on the 1999 HUD Appropriations Act that the Department clarify its position on this subject, HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and the Truth in Lending Act (TILA) for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions and providing creditors and

mortgage brokers with clearer rules. Such an approach is far preferable to piecemeal actions.

EFFECTIVE DATE: This Statement of Policy is effective March 1, 1999.

FOR FURTHER INFORMATION CONTACT: Rebecca J. Holtz, Director RESPA/ILS Division Room 9146, Department of Housing and Urban Development, Washington, DC 20410; telephone 202-708-4560, or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/RESPA or Rodrigo Alba, Attorney for RESPA, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone 202-708-3137 (these are not toll free numbers). Hearing or speech-impaired individuals may access these numbers via TTY by calling the toll-free Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION: This Preamble to the Statement of Policy includes descriptions of current practices in the industry. It is not intended to take positions with respect to the legality or illegality of any practices; such positions are set forth in the Statement of Policy itself.

I. Background

A. General Background

The Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. 260 (1998)) (FY 1999 HUD Appropriations Act) directs HUD to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of the FY 1999 HUD Appropriations Act on October 21, 1998. The Report states that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) of the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*)

(RESPA)]" (Id.). The Report also states that the Conferees "are concerned about the legal uncertainty that continues absent such a policy statement" and "expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement" (Id.).

This issue of lender payments, or indirect fees, to mortgage brokers has proven particularly troublesome for industry and consumers alike. It has been the subject of litigation in more than 150 cases nationwide (see additional discussion below). To understand the issue and HUD's position regarding the legality of these payments requires background information concerning the nature of the services provided by mortgage brokers and their compensation, as well as the applicable legal requirements under RESPA.

During the last seven years, HUD has conducted three rulemakings respecting mortgage broker fees. These rulemakings first addressed definitional issues and issues concerning disclosure of payments to mortgage brokers in transactions covered under RESPA. (See 57 FR 49600 (November 2, 1992); 60 FR 47650 (September 13, 1995).) Most recently in a regulatory negotiation (see 60 FR 54794 (October 25, 1995) and 60 FR 63008 (December 8, 1995)) and then a proposed rule (62 FR 53912 (October 16, 1997)), HUD addressed the issue of the legality of payments to brokers under RESPA. In the latter, HUD proposed that payments from lenders to mortgage brokers be presumed legal if the mortgage broker met certain specified conditions, including disclosing its role in the transaction and its total compensation through a binding contract with the borrower. This rulemaking is pending.

In July 1998, HUD and the Board of Governors of the Federal Reserve delivered to Congress a joint report containing legislative proposals to reform RESPA and the Truth in Lending Act. If the proposals in this reform package were to be adopted, the disclosure and legality issues raised herein would be resolved for any

mortgage broker following certain of the proposed requirements, and consumers would be offered significant new protections.

B. Mortgage Brokerage Industry

When RESPA was enacted in 1974, single family mortgages were largely originated and held by savings and loans, commercial banks, and mortgage bankers. During the 1980's and 1990's, the rise of secondary mortgage market financing resulted in new wholesale and retail entities to compete with the traditional funding entities to provide mortgage financing. This made possible the origination of loans by retail entities that worked with prospective borrowers, collected application information, and otherwise processed the data required to complete the mortgage transaction. These retail entities generally operated with the intent of developing the origination package, and then immediately transmitting it to a wholesale lender who funded the loan. The rise in technology permitted much more effective and faster exchange of information and funds between originators and lenders for the retail transaction.

Entities that provide mortgage origination or retail services and that bring a borrower and a lender together to obtain a loan (usually without providing the funds for loans) are generally referred to as "mortgage brokers." These entities serve as intermediaries between the consumer and the entity funding the loan, and currently initiate an estimated half of all home mortgages made each year in the United States. Mortgage brokers generally fit into two broad categories: those that hold themselves out as representing the borrower in shopping for a loan, and those that simply offer loans as do other retailers of loans. The first type may have an agency relationship the borrower and, in some states, may be found to owe a [*10081] responsibility to the borrower in connection with the agency representation. The second type, while not representing the borrower, may make loans available to consumers from any

number of funding sources with which the mortgage broker has a business relationship.

Mortgage brokers provide various services in processing mortgage loans, such as filling out the application, ordering required reports and documents, counseling the borrower and participating in the loan closing. They may also offer goods and facilities, such as reports, equipment, and office space to carry out their functions. The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders.

Mortgage brokers vary in their methods of collecting compensation for their work in arranging, processing, and closing mortgage loans. In a given transaction, a broker may receive compensation directly from the borrower, indirectly in fees paid by the wholesaler or lender providing the mortgage loan funds, or through a combination of both.

Where a broker receives direct compensation from a borrower, the broker's fee is likely charged to the borrower at or before closing, as a percentage of the loan amount (e.g., 1% of the loan amount) and through direct fees (such as an application fee, document preparation fee, processing fee, etc.).

Brokers also may receive indirect compensation from lenders or wholesalers. Such indirect fees may be referred to as "back funded payments," "servicing release premiums," or "yield spread premiums." These indirect fees paid to mortgage brokers may be based upon the interest rate of each loan entered into by the broker with the borrower. These fees have been the subject of

much contention and litigation. Another method of indirect compensation, also the subject of significant controversy and uncertainty, is "volume-based" compensation. This generally involves compensation to a mortgage broker by a lender based on the volume of loans that the mortgage broker delivers to the lender in a fixed period of time. The compensation may come in the form of: (1) a cash payment to the broker based on the amount of loans the broker delivers to the lender in excess of a "threshold" or "floor amount"; or (2) provision of a lower "start rate" (often called a discount) for such loans; the compensation to the broker results from the difference in yield between the "start rate" and the loan rate. Volume based compensation may be received at settlement or well after a particular loan has closed.

Payments to brokers by lenders, characterized as yield spread premiums, are based on the interest rate and points of the loan entered into as compared to the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a loan with a par rate of 7.75% and no points).[1] In determining the price of a loan, mortgage brokers rely on rate quotes issued by lenders, sometimes several times a day. When a lender agrees to purchase a loan from a broker, the broker receives the then applicable pricing for the loan based on the difference between the rate reflected in the rate quote and the rate of the loan entered into by the borrower. In some cases, the broker can increase its revenues by arranging a loan with the consumer at a particular rate and then, based on market changes or other factors which decrease the par rate, increase his or her fees. Some consumers allege that the compensation system for brokers results in higher loan rates for borrowers and/or that this compensation system is illegal under RESPA.

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[1] The term "par rate" refers to the rate offered to the broker (through the lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the broker.

Lender payments to mortgage brokers may reduce the up-front costs to consumers. This allows consumers to obtain loans without paying direct fees themselves.[2] Where a broker is not compensated by the consumer through a direct fee, or is partially compensated through a direct fee, the interest rate of the loan is increased to compensate the broker or the fee is added to principal. In any of the compensation methods described, all costs are ultimately paid by the consumer, whether through direct fees or through the interest rate.

C. Coverage of This Policy Statement

HUD's RESPA rules, found at 24 CFR part 3500 (Regulation X), define a mortgage broker to be "a person (not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally-related mortgage loan, and who renders * * * 'settlement services'" (24 CFR 3500.2(b)). In table funding, mortgage brokers may process and close loans in their own names. However, at or about the time of settlement, they transfer these loans to the lender, and the lender simultaneously advances the monies to fund the loan. In transactions where mortgage brokers function as intermediaries, the broker also provides loan origination services, but the loan funds are provided by the lender and the loan is closed in the lender's name.

In other cases, mortgage brokers may originate and close loans in their own name using their own funds or warehouse lines of credit, and then sell the loans after settlement in the secondary market. In such transactions, mortgage brokers effectively act as lenders under HUD's RESPA rules. Accordingly, the transfer of the loan obligation by, and payment to, these brokers after

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[2] In many instances, these loans are called "no cost" or "no fee" loans. This terminology, however, may prove confusing because in such cases the costs are still paid by the borrower through a higher interest rate on the loan or by adding fees to principal. HUD's regulations implementing RESPA use the name "no cost" or "no point" loans consistent with industry practice.

the initial funding is outside of RESPA's coverage under the secondary market exemption, found at 24 CFR 3500.5(b)(7), which states that payments to and from other loan sources following settlement are exempt from disclosure requirements and Section 8 restrictions. HUD's rule provides that in determining what constitutes a *bona fide* transfer in the secondary market, HUD considers the real source of funding and the real interest of the funding lender. (24 CFR 3500.5(b)(7).)

Because this Statement of Policy focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table-funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exemption.

D. RESPA and Its Legislative History

In enacting RESPA, Congress sought to protect the American home-buying public from unreasonably and unnecessarily inflated prices in the home purchasing process (S. Rep. No. 93-866 (1974) *reprinted in* 1974 [*10082] U.S.C.C.A.N. 6548). Section 2 of the Act provides:

"significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. * * * It is the purpose of this act to effect certain changes in the settlement process for residential real estate that will result — in more effective advance disclosure to home buyers and sellers of settlement costs; [and]

(2) In the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services. * * *" 12 U.S.C. 2601.

Section 4(a) of RESPA requires the Secretary to create a uniform settlement statement which "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement" (12 U.S.C. 2603(a)).

Section 5(c) of RESPA requires the provision of a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary" (12 U.S.C. 2604(c)).

Section 8(a) of RESPA, prohibits any person from giving and any person from accepting any fee, kickback, or other thing of value pursuant to any agreement or understanding that business shall be referred to any person. (See 12 U.S.C. 2607(a).) Section 8(b) also prohibits anyone from giving or accepting any portion, split, or percentage of any charge made or received for the rendering of a settlement service other than for services actually performed. (12 U.S.C. 2607(b).) Section 8(c) of RESPA provides, however, that nothing in Section 8 shall be construed as prohibiting the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or services actually performed. (12 U.S.C. 2607(c)(2).)

Under Section 19 of RESPA, HUD is authorized to issue rules, establish exemptions, and make such interpretations as is necessary to implement the law. (12 U.S.C. 2618(a).)

RESPA's legislative history refers to HUD-VA Reports and subsequent hearings by the Housing Subcommittee as defining "major problem areas that [had to] be dealt with if settlement costs are to be kept within reasonable bounds." (S. Rep. No. 93-866, at 6547.) One "major problem area" identified was the "[a]busive and unreasonable practices within the real estate settlement process that increase settlement costs to home buyers without providing any real benefits to them." Another major concern was "[t]he lack of understanding on the

part of most home buyers about the settlement process and its costs, which lack of understanding makes it difficult for a free market for settlement services to function at maximum efficiency."

The legislative history reveals that Congress intended RESPA to guard against these unreasonable and excessive settlement costs in two ways. Under Section 4, Congress sought to "mak[e] information on the settlement process available to home buyers in advance of settlement and requir[e] advance disclosures of settlement charges." (S. Rep. 93-866, at 6548.) The Senate Report explained that "home buyers who would otherwise shop around for settlement services, and thereby reduce their overall settlement costs, are prevented from doing so because frequently they are not apprised of the costs of these services until the settlement date or are not aware of the nature of the settlement services that will be provided."

Under Section 8, Congress sought to eliminate what it termed "abusive practices" — kickbacks, referral fees, and unearned fees. In enacting these prohibitions, Congress intended that "the costs to the American home buying public will not be unreasonably or unnecessarily inflated." (S. Rep. 93-866 at 6548.) In describing the Section 8 provisions, the Senate Report explained that RESPA "is intended to prohibit all * * * referral fee arrangements whereby any payment is made or 'thing of value' is provided for the referral of real estate settlement business." (S. Rep. 93-866, at 6551.)

The legislative history adds that "[t]o the extent the payment is in excess of the reasonable value of the goods provided or services performed, the excess may be considered a kickback or referral fee proscribed by Section [8]." (S. Rep. 93-866, at 6551.) The Senate Report states that "reasonable payments in return for services actually performed or goods actually furnished"

were not intended to be prohibited (Id).[3] It also provided that "[t]hose persons and companies that provide settlement services should therefore take measures to ensure that any payments they make or commissions they give are not out of line with the reasonable value of the services received." (*Id.*)

The Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers, because RESPA applies to the origination, processing, and funding of a federally related mortgage loan. This became an issue when, in 1984, the 6th Circuit Court of Appeals held that in applying Section 8 as a criminal statute, the definition of settlement services did not clearly extend to the making of a mortgage loan. (*U.S.* versus *Graham Mortgage Corp.*, 740 F.2d 414 (6th Cir. 1984).) In 1992, Congress responded by amending RESPA to remove any doubt that, for purposes of RESPA, a settlement service includes the origination and making of a mortgage loan. (Section 908 of the Housing and Community Development Act of 1992 (Pub. L. 102-550, approved October 28, 1992; 104 Stat. 4413). At the same time, Congress also specifically made RESPA applicable to second mortgages and refinancings. (*Id.*)

E. HUD's RESPA Rules

On November 2, 1992 (57 FR 49600), the Department issued a major revision of Regulation X, the rule interpreting RESPA. The rule defined the term "mortgage broker" for the first time. Under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR

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[3] One of the examples of abusive activities listed in the legislative history that RESPA was intended to remedy is "a title insurance company [that] may give 10% or more of the title insurance premium to an attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application." (S. Rep. 93-866, at 6551.) Accordingly, where insufficient services are provided, RESPA is intended to prohibit payment.

3500.7(a) and (c).) Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A (Instructions for Filling Out the HUD-1 and HUD-1A).) On the GFE and the settlement statement, lender-paid mortgage broker fees must be shown as "Paid Outside of Closing" (P.O.C.), and not computed in arriving at totals. (See 24 CFR 3500.7(a)(2) and 24 CFR part 3500, Appendix A.) The 1992 rule treats mortgage brokers as settlement service providers whose fees are disbursed at or before settlement, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure and otherwise subject to RESPA, including Section 8.

The 1992 rule did not explicitly take a position on whether yield spread premiums or any other named class of back-funded or indirect fees paid by lenders to brokers are *per se* legal or illegal. By illustration, codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B [*10083] to 24 CFR part 3500, the 1992 rule specifically listed "servicing release premiums" and "yield spread premiums" as fees required to be itemized on the settlement statement. Although the 1992 rule specifically acknowledged the existence of such fees and provided illustrations of how they were to be denominated on HUD disclosure forms, this requirement was intended to ensure their disclosure, but not to create a presumption of *per se* legality or illegality.

The anti-kickback, anti-referral fee and unearned fee provisions of RESPA are implemented by 24 CFR 3500.14. Regulation X repeats the Section 8 prohibitions against compensation for the referral of settlement service business and for the giving or accepting of any portion, split or percentage of any charge other than for services actually rendered. (24 CFR 3500.14(c).) Regulation X provides that a charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates the

unearned fee prohibition. (See 24 CFR 3500.14(c).) Moreover, 24 CFR 3500.14(g)(1)(iv) clarifies that Section 8 of RESPA permits "[a] payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

The Department's regulations provide, under 24 CFR 3500.14(g)(2), that:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. *If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided.* These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. * * * (emphasis supplied).

In addition, Regulation X clarifies that "[w]hen a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person." (24 CFR 3500.14(g)(3).)

Since 1992, HUD has provided various interpretations and other issuances under these rules stating the Department's position that the legality of a payment to a mortgage broker is not premised on the name of the particular fee. Rather, HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker in covered transactions is reasonably related to the value of the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or

8(b) of RESPA, whether the compensation is a direct or indirect payment or a combination thereof.

F. Recent HUD Rulemaking Efforts

The Department received comments on the 1992 rule's requirement that mortgage brokers disclose indirect payments from lenders on the GFE and the settlement statement. In response, the Department reviewed whether the disclosure of indirect or back-funded fees is necessary or in the borrower's interest and whether additional rulemaking was needed to clarify the legality of fees to mortgage brokers. Brokers had alleged that these disclosures were confusing to consumers and disadvantaged brokers as compared to other originators who were within the secondary market exemption and were not required to disclose their compensation for the subsequent sale of the loan. Consumer representatives said that consumers needed to understand the existence of indirect fees and whether brokers represented consumers in shopping for loans. On September 13, 1995, the Department issued a proposed rule (60 FR 47650) and in December 1995 through May 1996, embarked on a negotiated rulemaking on these subjects.

Although the negotiated rulemaking did not result in consensus, on October 16, 1997, HUD published a proposed rule (62 FR 53912) that was shaped by views from both industry and consumer representatives provided during the negotiated rulemaking (as well as by comments received from the September 13, 1995, proposed rule (60 FR 47650)). The 1997 proposed rule proposed a qualified "safe harbor" for payments to mortgage brokers under Section 8. Under the proposal, if a broker enters into a contract with consumers explaining the broker's functions (whether or not it represented the consumer) and the total compensation the broker would receive in the transaction, before the consumer applied for a loan, HUD would presume the broker fees, both direct and indirect, to be legal. The 1997 proposal also provided, however, that this qualified safe harbor would only be available to those payments that

did not exceed a test, to be established in the rulemaking, to preclude unreasonable fees. This proposal was intended, among other things, to establish that yield spread premiums paid to brokers meeting the rule's requirements were presumed legal when brokers provided consumers with prescribed information concerning the functions and compensation of mortgage brokers. The Department has received over 9,000 comments in response to this proposed rule.

G. Litigation

During the last several years, more than 150 lawsuits have been brought seeking class action certification based in whole or in part on the theory that the making of indirect payments from lenders to mortgage brokers violates Section 8 of RESPA. In various cases, plaintiffs have argued that yield spread premiums or other denominated indirect payments to brokers, regardless of their amount, constitute prohibited referral fees under Section 8(a). These plaintiffs generally argue that yield spread premiums are payments based upon the broker's ability to deliver a loan that is above the par rate. Some lawsuits have alleged that such yield spread premiums or other indirect payments are a split of fees between the lender and the broker, or are simply unearned fees and, therefore, also violate Section 8(b) of RESPA. Other challenges rely, in part, on the alleged unreasonableness of brokers' fees. These complaints assert that under the RESPA regulations, payments must bear a reasonable relationship to the market value of the good or the service provided and that payments in excess of such amounts must be regarded as forbidden referral fees.

Many of the lawsuits involve allegations that consumers were not informed by mortgage brokers concerning the mortgage brokers' role and compensation. A common element in many allegations is that borrowers were not informed about the existence or the amount of the yield spread premiums paid to the mortgage broker, and the relationship of the yield spread premium to the

direct fees that the borrower paid. The facts in these cases suggest generally that even where there were proper disclosures on the GFE and the settlement statement, borrowers allege that they were unaware of, or did not understand, that a yield spread premium was tied to the interest rate they agreed to pay, and that they could have reduced this charge or their direct [*10084] payment to the broker either by further negotiation or by engaging in additional shopping among mortgage loan providers.

Courts have been split in their decisions on these cases. Some of the decisions have concluded that yield spread premiums may be prohibited referral fees or duplicative fees in contravention of Section 8 of RESPA under the specific facts of the case. Some have held that the permissibility of yield spread premiums must be based on an analysis of whether the premiums constitute a reasonable payment, either alone or in combination with any direct fee paid by the borrower, for either the goods, services or facilities actually furnished. Because some courts have found that this necessitates an individual analysis of the facts of each transaction, some courts have denied plaintiffs' requests for class action certification. Some courts have certified a class without reaching a conclusion on the RESPA issues. Others have held that yield spread premiums constitute valid consideration to the mortgage broker in exchange for the origination of the loan and the sale of the loan to the lender. These courts have found that the payment of yield spread premiums is one method among many of compensating the broker for the origination services rendered.

H. Reform

In July 1998, the Department and the Federal Reserve Board delivered a report to Congress recommending significant improvements to streamline and simplify current RESPA and Truth In Lending Act requirements. The Report proposed that along with a tighter and more enforceable scheme for providing consumers with esti-

mated costs for settlements, an exemption from Section 8's prohibitions should be established for those entities that offer a package of settlement services and a mortgage loan at a guaranteed price, rate and points for the package early in the consumer's process of shopping for a loan. Such an approach, which also includes other additional consumer protection recommendations, would largely resolve these issues for any mortgage broker who chooses to abide by the requirements of this exemption. The Report's consumer protection recommendations included, among other items, that Congress consider establishment of an unfair and deceptive acts and practices remedy.

Under the "packaging" proposal set forth in the Report, settlement costs would be controlled more effectively by market forces. Consumers would be better able to comparison-shop, thereby encouraging creditors and others to operate efficiently and pass along discounts and lower prices. In addition, the Report's recommendations would greatly simplify compliance for the industry and clarify legal uncertainties that create liability risks.

I. This Policy Statement

This policy statement provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law. In accordance with the Conference Report, in developing this policy statement, HUD met with representatives of government agencies, as well as a broad range of consumer and industry groups, including the Office of Thrift Supervision, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Association of Mortgage Brokers, the Mortgage Bankers Association of America, the American Bankers Association, the Consumer Mortgage Coalition, America's Community Bankers, the Consumer Bankers Association, the Independent Bankers Association of America, AARP, the National Consumer Law Center, Consumers Union, and the National Association of Consumer Advocates.

II. RESPA Policy Statement 1999-1

A. Introduction

The Department hereby states its position on the legality of payments by lenders to mortgage brokers under the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA) and its implementing regulations at 24 CFR part 3500 (Regulation X). This Statement of Policy is issued pursuant to Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii). HUD is cognizant of the Conferees' statement in the Conference Report on the FY 1999 HUD Appropriations Act that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. Sec. 2607) in its enactment of RESPA." (H. Rep. 105-769, at 260.) The Department is also cognizant of the congressional intent in enacting RESPA of protecting consumers from unnecessarily high settlement charges caused by abusive practices. (12 U.S.C. 2601.)

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (i.e., yield spread premiums or any other class of named payments), to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage

broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets.

B. Scope

In light of 24 CFR §3500.5(b)(7), which exempts from RESPA coverage *bona fide* transfers of loan obligations in the secondary market, this policy statement encompasses only transactions where mortgage brokers are not the real source of funds (i.e., table-funded transactions or transactions involving "intermediary" brokers). In table-funded transactions, the mortgage broker originates, processes and closes the loan in the broker's own name and, at or about the time of settlement, there is a simultaneous advance of the loan funds by the lender and an assignment of the loan to that lender. (See 24 CFR 3500.2 (Definition of "table funding").) Likewise, in transactions where [*10085] mortgage brokers are intermediaries, the broker provides loan origination services and the loan funds are provided by the lender; the loan, however, is closed in the lender's name.

C. Payments Must Be for Goods, Facilities or Services

In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker. In making the determination of whether compensable services are performed, HUD's letter to the Independent Bankers Association of America, dated February 14, 1995 (IBAA letter) may be useful. In that letter, HUD identified the following services normally performed in the origination of a loan:

(a) Taking information from the borrower and filling out the application;[4]

(b) Analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;

(c) Educating the prospective borrower in the home buying and financing process, advising the borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product;

(d) Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;

(e) Initiating/ordering VOEs (verifications of employment) and VODs (verifications of deposit);

(f) Initiating/ordering requests for mortgage and other loan verifications;

(g) Initiating/ordering appraisals;

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[4] In a subsequent informal interpretation, dated June 20, 1995, HUD stated that the filling out of a mortgage loan application could be substituted by a comparable activity, such as the filling out of a borrower's worksheet.

(h) Initiating/ordering inspections or engineering reports;

(i) Providing disclosures (truth in lending, good faith estimate, others) to the borrower;

(j) Assisting the borrower in understanding and clearing credit problems;

(k) Maintaining regular contact with the borrower, realtors, lender, between application and closing to appraise them of the status of the application and gather any additional information as needed;

(l) Ordering legal documents;

(m) Determining whether the property was located in a flood zone or ordering such service; and

(n) Participating in the loan closing.

While this list does not exhaust all possible settlement services, and while the advent of computer technology has, in some cases, changed how a broker's settlement services are performed, HUD believes that the letter still represents a generally accurate description of the mortgage origination process. For other services to be acknowledged as compensable under RESPA, they should be identifiable and meaningful services akin to those identified in the IBAA letter including, for example, the operation of a computer loan origination system (CLO) or an automated underwriting system (AUS).

The IBAA letter provided guidance on whether HUD would take an enforcement action under RESPA. In the context of the letter's particular facts and subject to the reasonableness test which is discussed below, HUD articulated that it generally would be satisfied that sufficient origination work was performed to justify compensation if it found that:

- The lender's agent or contractor took the application information (under item (a)); and

- The lender's agent or contractor performed at least five additional items on the list above.

In the letter and in the context of its facts, HUD also pointed out that it is concerned that a fee for steering a customer to a particular lender could be disguised as compensation for "counseling-type" activities. Therefore, the letter states that if an agent or contractor is relying on taking the application and performing only "counseling type" services — (b), (c), (d), (j), and (k) on the list above — to justify its fee, HUD would also look to see that meaningful counseling — not steering — is provided. In analyzing transactions addressed in the IBAA letter, HUD said it would be satisfied that no steering occurred if it found that:

- Counseling gave the borrower the opportunity to consider products from at least three different lenders;
- The entity performing the counseling would receive the same compensation regardless of which lender's products were ultimately selected; *and*
- Any payment made for the "counseling-type" services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

In examining services provided by mortgage brokers and payments to mortgage brokers, HUD will look at the types of origination services listed in the IBAA letter to help determine whether compensable services are performed.[5] However, the IBAA letter responded to a program where a relatively small fee was to be provided for limited services by lenders that were brokering loans.[6]

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[5] In the June 20, 1995 letter, the Department clarified that the counseling test in the IBAA letter would not apply if an entity performed only non-counseling services (a, e, f, g, h, i, l, m, n) or a mix of counseling and non-counseling services (but did not rely only on the five counseling services (b, c, d, j, and k)).

[6] In the particular program reviewed by HUD in the IBAA letter, the average total compensation for performing six of the origination services listed above was below $200.

Accordingly, the formulation in the IBAA letter of the number of origination services which may be required to be performed for compensation is not dispositive in analyzing more costly mortgage broker transactions where more comprehensive services are provided. The determinative test under RESPA is the relationship of the services, goods or facilities furnished to the total compensation received by the broker (discussed below). In addition to services, mortgage brokers may furnish goods or facilities to the lender. For example, appraisals, credit reports, and other documents required for a complete loan file may be regarded as goods, and a reasonable portion of the broker's retail or "store-front" operation may generally be regarded as a facility for which a lender may compensate a broker. However, while a broker may be compensated for goods or facilities actually furnished or services actually performed, the loan itself, which is arranged by the mortgage broker, cannot be regarded as a "good" that the broker may sell to the lender and that the lender may pay for based upon the loan's yield's relation to market value, reasonable or otherwise. In other words, in the context of a non-secondary market mortgage broker transaction, under HUD's rules, it is not proper to argue that a loan is a "good," in the sense of an instrument bearing a particular yield, thus justifying any yield spread premium to the mortgage broker, however great, on the grounds that such yield spread premium is the "market value" of the good.

D. Compensation Must Be Reasonably Related to Value of Goods, Facilities or Services

The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker, as described in the IBAA letter, does not by itself make a payment by a lender to a mortgage [*10086] broker legal. The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. Although RESPA

is not a rate-making statute, HUD is authorized to ensure that payments from lenders to mortgage brokers are reasonably related to the value of the goods or facilities actually furnished or services actually performed, and are not compensation for the referrals of business, splits of fees or unearned fees.

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets.[7] If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. (See 24 CFR 3500.14(g)(2).) Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA. Congress was clear that for payments to be legal under Section 8, they must bear a reasonable relationship to the value received by the person or company making the payment. (S. Rep. 93-866, at 6551.)

The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or

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[7] HUD recognizes that settlement costs may vary in different markets. The cost of a specific service in Omaha, Nebraska, for example, may bear little resemblance to the cost of a similar service in Los Angeles, California.

services are performed or provided for the lender, for the consumer, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible (e.g., an appraisal is necessary to assure that the lender has adequate security, as well as to advise the borrower of the value of the property and to complete the borrower's loan).

The consumer is ultimately purchasing the total loan and is ultimately paying for all the services needed to create the loan. All compensation to the broker either is paid by the borrower in the form of fees or points, directly or by addition to principal, or is derived from the interest rate of the loan paid by the borrower. Accordingly, in analyzing whether lender payments to mortgage brokers comport with the requirements of Section 8 of RESPA, HUD believes that the totality of the compensation to the mortgage broker for the loan must be examined. For example, if the lender pays the mortgage broker $600 and the borrower pays the mortgage broker $500, the total compensation of $1,100 would be examined to determine whether it is reasonably related to the goods or facilities actually furnished or services actually performed by the broker.

Therefore, in applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether total compensation is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. All payments, including payments based upon a percentage of the loan amount, are subject to the reasonableness test defined above. In applying this test, the Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that

total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In so-called "no-cost" loans, borrowers accept a higher interest rate in order to reduce direct fees, and the absence of direct payments to the mortgage broker is made up by higher indirect fees (e.g., yield spread premiums). Higher indirect fees in such arrangements are legal if, and only if, the total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In determining whether the compensation paid to a mortgage broker is reasonably related to the goods or facilities actually furnished or services actually performed, HUD will consider all compensation, including any volume based compensation. In this analysis, there may be no payments merely for referrals of business under Section 8 of RESPA. (See 24 CFR 3500.14.)[8]

Under HUD's rules, when a person in a position to refer settlement service business receives a payment for providing additional settlement services as part of the transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by the person. (24 CFR 3500.14(g)(3).) While mortgage brokers may receive part of their compensation from a lender, where the lender payment duplicates direct compensation paid by the borrower for goods or facilities actually furnished or services actually performed, Section 8 is violated. In light of the fact that the borrower and the lender may both contribute to some items, HUD believes that it is best to evaluate seemingly duplicative fees by analyzing total compensation under the reasonableness test described above.

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[8] The Department generally has held that when the payment is based on the volume or value of business transacted, it is evidence of an agreement for the referral of business (unless, for example, it is shown that payments are for legitimate business reasons unrelated to the value of the referrals). (See 24 CFR 3500.14(e).)

E. Information Provided to Borrower

Under current RESPA rules mortgage brokers are required to disclose estimated direct and indirect fees on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (b).) Such disclosure must also be provided to consumers, as a final exact figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, AppendixA.) On the GFE and the settlement statement, lender payments to mortgage brokers must be shown as "Paid Outside of Closing" (P.O.C.), and are not computed in arriving at totals. (24 CFR 3500.7(a)(2).) The requirement that all fees be disclosed on the GFE is intended to assure that consumers are shown the full amount of compensation to brokers and others early in the transaction.

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like "YSP to DBG, POC", for instance, have been noted.[9] Also, the Department has seen [*10087] examples on the GFE and/or the settlement statement where the identity and/or purpose of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee

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[9] This is an example only. HUD recognizes that current practices may leave borrowers confused. However, the use of any particular terms, including abbreviations, may not, by itself, violate RESPA. Nevertheless, going forward, HUD recommends that the disclosures on the GFE and the settlement statement be as described in the text. HUD recognizes that system changes may require time for lenders and brokers to implement.

(in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. For example, a fee would be appropriately disclosed as "Mortgage broker fee from lender to XYZ Corporation (P.O.C.)." In the interest of clarity, other fees or payments from the borrower to the mortgage broker should identify that they are mortgage broker fees from the borrower.[10]

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. Mortgage brokers and lenders can improve their ability to demonstrate the reasonableness of their fees if the broker discloses the nature of the broker's services and the various methods of compensation at the time the consumer first discusses the possibility of a loan with the broker.

The legislative history makes clear that RESPA was not intended to be a rate-setting statute and that Congress instead favored a market-based approach. (S. Rep. No. 93-866 at 6546 (1974).) In making the determination of whether a payment is *bona fide* compensation for goods or facilities actually furnished or services actually performed, HUD has, in the past, indicated that it would examine whether the price paid for the goods, facilities or services is truly a market price; that is, if in an arm's length transaction a purchaser would buy the services at or near the amount charged. If the fee the consumer pays is disclosed and agreed to, along with its relationship to the interest rate and points for the loan

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[10] HUD recognizes that current software may not currently accommodate these additional disclosures. Both industry and consumers would be better served if these additional disclosures were included in future forms.

and any lender-paid fees to the broker, a market price for the services, goods or facilities could be attained. HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, pre-application disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding.

HUD commends the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting that their members furnish consumers with a form describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from a lender.

Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up that compensation. If indirect fees are paid, the consumer would be made aware of the amount of these fees and their relationship to direct fees and an increased interest rate. If the consumer may reduce the interest rate through increased fees or points, this option also would be explained. HUD

recognizes that in many cases, the industry has not been using this approach because it has not been required. Moreover, new methods may require time to implement. HUD encourages these efforts going forward and believes that if these desirable disclosure practices were adhered to by all industry participants, the need for more prescriptive regulatory or legislative actions concerning this specific problem could be tempered or even made unnecessary.

While the Department is issuing this statement of policy to comply with a Congressional directive that HUD clarify its position on the legality of lender payments to mortgage brokers, HUD agrees with segments of the mortgage lending and settlement service industries and consumer representatives that legislation to improve RESPA is needed. HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and TILA for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions and providing creditors and mortgage brokers with clearer rules.

III. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this Statement of Policy under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this Statement of Policy is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the Statement of Policy subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the office of the Department's

Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410-0500.

Dated: February 22, 1999.

William C. Apgar,

Assistant Secretary for Housing – Federal Housing Commissioner.

APPENDIX L

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR-3638-N-05]

Real Estate Settlement Procedures Act (RESPA); Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation

AGENCY: Office of the Assistant Secretary for Housing – Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 1996-3, Rental of Office Space, Lock-outs, and Retaliation.

[June 7, 1996; 61 Fed. Reg. 29264]

SUMMARY: This statement sets forth the Department's interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) and its implementing regulations with regard to the rental of office space, lock-outs and retaliation. It is published to give guidance and to inform interested members of the public of the Department's position on enforcement of this section of the law.

FOR FURTHER INFORMATION CONTACT: David R. Williamson, Director of the Office of Consumer and Regulatory Affairs, Room 5241, telephone: (202) 708-4560. For legal enforcement questions, Peter Race, Assistant General Counsel for Program Compliance, or Rebecca J. Holtz, Attorney, Room 9253, telephone: (202) 708-4184. (The telephone numbers are not toll-free.) For hearing- and speech-impaired persons, this number may be accessed via TTY (text telephone) by calling the Federal Information Relay Service at 1-800-877-8339. The address for the above-listed persons is: Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410.

SUPPLEMENTARY INFORMATION:

General Background

Section 8 (a) of the Real Estate Settlement Procedures Act (RESPA) prohibits any person from giving or accepting any fee, kickback, or thing of value for the referral of settlement service business involving a federally related mortgage loan. 12 U.S.C. 2607(a). Congress specifically stated it intended to eliminate kickbacks and referral fees that tend to increase unnecessarily the costs of settlement services. 12 U.S.C. 2601(b)(2).

Since July 1993, the Department has been seeking comments and advice concerning the final rule of November 2, 1992, implementing Section 8 of RESPA. On July 21, 1994, the Department published a new proposed rule on certain Section 8 issues. Simultaneously with the issuance of this Statement of Policy, HUD is publishing a final rule in that rulemaking. As part of that rulemaking process, the Department received comments concerning the application of Section 8 of RESPA to the rental of office space, lock-outs and retaliation in connection with real estate brokerage office practices. In addition, the Department's enforcement officials have received numerous complaints dealing with these same issues.

Rental of Office Space

In the last few years, the Department has received numerous complaints alleging that certain settlement service providers, particularly lenders, are leasing desks or office space in real estate brokerage offices at higher than market rate in exchange for referrals of business. In HUD's rulemaking docket, number R-94-1725 (FR-3638), many commenters argued that HUD should scrutinize this rental practice. The concern expressed is that real estate brokers charge, and settlement service providers pay, high rent payments for the desk or office space to disguise kickbacks to the real estate broker for the referral of business to the settlement service provider. In this Statement of Policy, the Department

sets forth how it distinguishes legitimate payments for rentals from payments that are for the referral of business in violation of Section 8.

Lock-outs

The Department also received comments and complaints alleging that settlement service providers were being excluded from, or locked-out of, places of business where they might find [*29265] potential customers. The most common occurrence cited was where a real estate brokerage company had leased space to a particular provider of services, and had prevented any other provider from entering its office space.

As part of the July 21, 1994, rulemaking, a Nebraska lender commented:

> We are experiencing a rapid growth of lender lock-out relationships wherein real estate companies lease office space within their sales offices to a particular mortgage company. A part of the agreement is that other lenders are not allowed in the sales offices to solicit business. This clearly prevents free competition in financing to the home buyer.
>
> * * * * *
>
> * * * [I]t is very clear that the [real estate] office managers are exerting a lot of control to keep all other lenders out. This would not be done without proper incentive ($$$) * * *.

Several other commenters alleged that real estate office space arrangements with particular lenders, coupled with limiting or denying rival lenders access to customers, were being used in their communities to eliminate competition. These commenters called for special RESPA rules to ban these practices.

Retaliation

The Department also has received complaints concerning retaliation practices used to influence consumer referrals. In one complaint, financial service representatives in a real estate broker's office were given specific quotas of referrals of home buyers to an affiliated lender

and were threatened with the loss of their jobs if they did not meet the quotas.

Commenters on the proposed rules also alleged that some employers were engaging in practices of retaliation or discrimination against employees and agents who did not refer business to affiliated entities. Reprisals could range from loss of benefits, such as fewer sales leads, higher desk fees, less desirable work space, and ultimately, loss of job. Some commenters requested that the Department issue guidelines or other regulatory provisions to restrict such retaliatory activities.

The Coalition to Retain Independent Services in Settlement (CRISIS) called for a rule prohibiting retaliation against employees and agents who refer business to non-affiliated entities as most consistent with the language of the RESPA statute. CRISIS suggested strong language to prohibit negative actions against employees and agents who refer business to non-affiliated entities, including prohibitions against more subtle actions, such as loss of work space or increases in desk fees.

Statement of Policy — 1996-3

To give guidance to interested members of the public on the application of RESPA and its implementing regulations to these issues, the Secretary, pursuant to Section 19(a) of RESPA and 24 CFR 3500.4(a)(1)(ii),[1] hereby issues the following Statement of Policy.

Rental of Office Space

Section 8 of RESPA prohibits a person from giving or from accepting any fee, kickback or thing of value pursuant to an agreement that business incident to a settlement service involving a federally related mortgage loan shall be referred to any person. 12 U.S.C. § 2607(a). An example of a thing of value is a rental

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[1] All citations in this Statement of Policy refer to recently streamlined regulations published on March 26, 1996 (61 FR 13232), in the Federal Register (to be codified at 24 CFR part 3500).

payment that is higher than that ordinarily paid for the facilities. The statute, however, permits payments for goods or facilities actually furnished or for services actually performed. 12 U.S.C. § 2607(c)(2). Thus, when faced with a complaint that a settlement service provider is paying a high rent for referrals of settlement service business, HUD analyzes whether the rental payment is bona fide or is really a disguised referral fee.

HUD's regulations implement the statutory provisions at 24 CFR 3500.14 and give greater guidance to this analysis. Section 3500.14(g)(2) of the regulations provides that the Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. It states: "If the payment bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided * * *. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services." *Id.*

Thus, under existing regulations, when faced with a complaint that a person is renting space from a person who is referring business to that person, HUD examines the facts to determine whether the rental payment bears a reasonable relationship to the market value of the rental space provided or is a disguised referral fee. The market value of the rental space may include an appropriate proportion of the cost for office services actually provided to the tenant, such as secretarial services, utilities, telephone and other office equipment. In some situations, a market price rental payment from the highest bidding settlement service provider could reflect payments for referrals of business to that settlement service provider from the person whose space is being rented. Thus, to distinguish between rental payments that may include a payment for referrals of settlement service business and a payment for the facility actually provided, HUD interprets the existing regulations to

require a "general market value" standard as the basis for the analysis, rather than a market rate among settlement service providers.

In a rental situation, the general market value is the rent that a non-settlement service provider would pay for the same amount of space and services in the same or a comparable building. A general market value standard allows payments for facilities and services actually furnished, but does not take into account any value for the referrals that might be reflected in the rental payment. A general market standard is not only consistent with the existing regulations, it furthers the statute's purpose. Congress specifically stated that it intended to protect consumers from unnecessarily high settlement charges caused by abusive practices. 12 U.S.C. § 2601. Some settlement service providers might be willing to pay a higher rent than the general market value to reflect the value of referrals of settlement service business. The cost of an above-general-market-rate rental payment could likely be passed on to the consumer in higher settlement costs. If referrals of settlement service business are taking place in a given rental situation, and the rental payment is above the general market value, then it becomes difficult to distinguish any increase in rental payment over the general market from a referral fee payment.

HUD, therefore, interprets Section 8 of RESPA and its implementing regulations to allow payments for the rental of desk space or office space. However, if a settlement service provider rents space from a person who is referring settlement service business to the provider, then HUD will examine whether the rental payments are reasonably related to the general market value of the facilities and services actually furnished. If the rental payments exceed the general market value of the space provided, then HUD will consider the excess amount to be for the referral of business in violation of Section 8(a). [*29266]

As an additional consideration, HUD will examine whether the rent is calculated, in whole or in part, on a multiple of the number or value of the referrals made. If the rental payment is conditioned on the number or value of the referrals made, then HUD will consider the rental payment to be for the referral of business in violation of Section 8(a).

In its RESPA enforcement work, HUD has also encountered "bogus" rental arrangements that are really agreements for the payment of referral fees. For example, one case involved a title insurance company that paid a "rental fee" to a real estate broker for the "per use rental" of a conference room for closings. The title insurance company paid a $100 fee for each transaction. This "rental fee" was greater than the general market value for the use of the space. In addition, the facts revealed that the room was rarely actually used for closings. In this case, HUD examined whether a "facility" was actually furnished at a general market rate. HUD concluded that this was a sham rental arrangement; the "rent" was really a disguised referral fee in violation of Section 8(a).

Lock-outs

A lock-out situation arises where a settlement service provider prevents other providers from marketing their services within a setting under that provider's control. A situation involving a rental of desk or office space to a particular settlement service provider could lead to other, competing, settlement service providers being "locked-out" from access to the referrers of business or from reaching the consumer. The existence of a lock-out situation could, therefore, give rise to a question of whether a rental payment is *bona fide*. A lock out situation without other factors, however, does not give rise to a RESPA violation.

The RESPA statute does not provide HUD with authority to regulate access to the offices of settlement service providers or to require a company to assist

another company in its marketing activity. This interpretation of RESPA does not bear on whether State consumer, antitrust or other laws apply to lock-out situations. Of course, Section 8 still applies to any payments made to a referrer of business by a settlement service provider who is not "locked out" of the referrer's office and receives referrals of settlement service business from that office.

Retaliation

Section 8 of RESPA expressly prohibits giving positive incentives, "things of value," for the referral of settlement service business. 12 U.S.C. 2607(a). The Act is silent as to disincentives. If HUD were to find that Section 8 also prohibited disincentives for failure to make referrals, HUD would find itself being called upon to resolve numerous employment disputes under RESPA. HUD does not believe that Congress intended that RESPA reach these matters. Retaliatory actions against employees are more appropriately governed by State labor, contract, and other laws. However, the Department will continue to examine for possible violations of Section 8 whether payments or other positive incentives are given employees or agents to make referrals to other settlement service providers.

New RESPA regulations are being issued simultaneously with this Statement of Policy. With regard to this area, the public should note the new exemptions for payments to employees in 24 CFR 3500.14.

Authority: 12 U.S.C. 2617; 42 U.S.C. 3535(d).

Dated: May 31, 1996.

Nicolas P. Retsinas,

Assistant Secretary for Housing—Federal Housing Commissioner.

APPENDIX M

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

Civil No. 00-1872
UNITED STATES OF AMERICA,
Plaintiff,
v.

DELTA FUNDING CORPORATION, AND
DELTA FINANCIAL CORPORATION,
Defendants.

[Filed March 30, 2000]

SETTLEMENT AGREEMENT AND ORDER

The United States of America, through the United States Department of Justice and on behalf of the Secretary of Housing and Urban Development and the Federal Trade Commission, and Delta Funding Corporation ("Delta Funding") and Delta Financial Corporation (except where otherwise noted, both defendants are collectively referred to as "Delta" or "the lender") have agreed to enter into this Settlement Agreement simultaneously with the filing of the United States of America's Complaint (the "Complaint") alleging that Delta has violated the Fair Housing Act (42 U.S.C. §§ 3601-3619) ("FHA"), the Equal Credit Opportunity Act (15 U.S.C. §§ 1691-1691f) and its implementing Regulation B (12 C.F.R. Part 202) (collectively, "ECOA"), the Home Ownership and Equity Protection Act of 1994 (15 U.S.C. § 1639) and its implementing Regulation Z (12 C.F.R. §§ 226.31-226.32) (collectively, "HOEPA"), and the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. § 2601-2617) and its implementing Regulation X (24 C.F.R. Part 3500) (collectively, "RESPA"), all as

amended. This Settlement Agreement resolves fully all claims in the United States' Complaint.

I. INTRODUCTION

This case is brought by the United States to vindicate the rights of persons whom the United States claims were injured by alleged violations of the fair lending, fair housing and consumer protection laws and regulations, as set forth above. The Complaint alleges that Delta is engaged in the business of making subprime home mortgage loans; that a large part of its business is con-centrated in the minority residential areas of Kings and Queens Counties, New York; that the majority of its loans are refinancing loans for the purpose of debt consolidation; that the majority of its borrowers in these counties are presented to Delta by mortgage brokers; that brokers submitting loans to Delta charge up to 10% of the loan amount as a "broker fee," unless state law provides for a lower amount; and that, during the period January 1996 through December 1998, approximately 17.5 percent of Delta's loans in Kings and Queens Counties, New York were high fee loans covered by HOEPA.

The United States alleges that Delta violated ECOA and FHA by approving and funding loans with disparate broker fees that resulted in African American female borrowers being charged more on average than white male borrowers were charged and that the higher prices charged to African American females were not based on differences in risk of repayment. The United States does not claim that Delta discriminated in charging borrowers disparate fees that were set by Delta, but rather in acceding to the discretionary prices that were charged by mortgage brokers for the loans made by Delta.

The United States alleges that Delta violated RESPA because it contends that in certain cases the fees received by mortgage brokers were not for services actually performed or were higher than an amount reasonably related to the value of goods and facilities provided and services performed, and, as such, constituted illegal

payments for the referral of mortgage loan business or unearned fees.

The United States alleges that Delta Funding violated HOEPA because it contends that Delta made certain loans based on borrowers' equity in their homes rather than the borrowers' ability to repay the obligation, and included prohibited prepayment and increased interest rate default provisions in certain HOEPA loan documents.

The allegations of the Complaint concern the period January 1996 through December 1998, during which Delta made more than 5,000 home mortgage loans to borrowers in Kings and Queens Counties, New York. Delta conducts its home mortgage lending business in more than 20 states other than New York, but almost half of its lending is in that state.

Delta denies all allegations in the United States' Complaint and that any of its actions have constituted violations of the ECOA, FHA, RESPA, HOEPA or any other fair housing, fair lending or consumer-protection law. In particular, Delta disputes the validity of the statistical analyses the United States relied upon as the principal basis for its ECOA and FHA claims, because Delta's own analyses did not reveal statistically significant differences in the prices paid by borrowers in protected classes. Delta further maintains that the United States' theories of liability regarding loans brought to it by mortgage brokers are legally insupportable, because, inter alia, they seek to hold a lender responsible for the conduct of independent third parties.

Delta disputes the United States' RESPA claims, and maintains that the broker compensation at issue in the Complaint was reasonably related to the value of the goods, facilities and services provided by brokers in similar transactions in similar markets.

Delta also disputes the United States' HOEPA claims, and contends that it underwrites all of its loans, including loans covered by HOEPA, based on the borrower's

ability to repay, and does not contract for or charge prohibited prepayment penalties or default interest on HOEPA loans.

Although Delta disputes each of the United States' allegations, it is nevertheless committed to furthering the spirit of fair lending and other consumer credit laws by going beyond what Delta believes is required under applicable law to remedy the violations alleged in the Complaint.

II. RESOLUTION OF THE DISPUTE

The parties have agreed that in order to avoid costly litigation, this controversy should be resolved voluntarily, and that the terms of this Settlement Agreement shall govern Delta's practices in all geographic areas in which Delta makes loans. The parties have also agreed that there should be no evidentiary hearing, trial or other adjudication on the merits, and that entry of this Settlement Agreement is not to be construed as an admission by Delta of the validity of the claims asserted against it.

Now therefore, on the basis of the foregoing representations of the United States and Delta, Delta, its officials, and employees, as well as their successors, collectively referred to as "Delta", are hereby ORDERED as follows:

III. GENERAL PROVISIONS

A. Delta is prohibited from engaging in any act or practice that discriminates on the basis of sex, race, or color in the pricing of mortgage loans as prohibited by FHA and ECOA, including but not limited to approving and funding loans for which minorities and females pay more than similarly situated whites or males.

B. Delta is prohibited from violating Section 8 of RESPA and Section 3500.14 of its implementing regulations, and agrees to conduct its dealings with mortgage loan brokers in a manner consistent with HUD's State-

ment of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers (64 Fed. Reg. 10080, March 1, 1999).

C. Delta Funding is further prohibited from violating HOEPA (15 U.S.C. § 1639), and Sections 226.31 and 226.32 of Regulation Z, 12 C.F.R. §§ 226.31 and 226.32, by:

1. engaging in a pattern or practice of extending credit to borrowers based on the borrowers' collateral rather than considering the borrowers' current or expected income, debt or employment status to determine whether the borrowers are able to make the scheduled payments to repay the obligations, in violation of Section 129(h) of HOEPA, 15 U.S.C. § 1639(h), and Section 226.32(e)(1) of Regulation Z, 12 C.F.R. § 226.32(e)(1);

2. including in a HOEPA mortgage loan a prohibited prepayment penalty provision, in violation of Section 129(c) of HOEPA, 15 U.S.C. § 1639(c), and Section 226.32(d)(6) of Regulation Z, 12 C.F.R. § 226.32(d)(6); and

3. including in a HOEPA loan a default provision calling for increased interest rate after default, in violation of Section 129(d) of HOEPA, 15 U.S.C. § 1639(d), and Section 226.32(d)(4) of Regulation Z, 12 C.F.R. § 226.32(d)(4).

IV. REQUIRED POLICIES AND PRACTICES CONCERNING DELTA'S BUSINESS DEALINGS WITH MORTGAGE BROKERS

A. Compliance With This Settlement Agreement

To promote the objectives of ECOA, FHA, RESPA AND HOEPA in connection with its wholesale lending operations, Delta shall conduct its business with mortgage brokers as follows:

1. With respect to fair lending, Delta shall:

a. adhere to the FHA and ECOA in all aspects of the credit process including pricing of mortgage loans;

b. reject the broker's proposal or make a counteroffer when it believes the broker's proposed compensation and costs are not permitted under the fair lending laws; and

c. maintain loan underwriting standards designed to ensure that loan applicants will be placed at the correct credit risk level on a non-discriminatory basis.

2. With respect to real estate settlement procedures, and consistent with HUD's Statement of Policy 1999-1 Delta shall:

a. only fund loans where it reasonably believes the compensation to the mortgage broker is made in exchange for services actually performed and goods and facilities actually furnished by the broker and the broker's total compensation is reasonably related to the services performed and the goods and facilities provided by the broker;

b. operate on the understanding that (i) payments to mortgage brokers by Delta for referral of business are not permissible and (ii) referral fees are not payments for goods, facilities or services;

c. where necessary to arrive at an overall mortgage broker compensation that is reasonably related to the services performed or the goods and facilities provided by the mortgage broker, reduce or eliminate its yield spread premiums or other back-end fees, propose a reduction in the mortgage broker's front-end charges or take other action. Delta shall

decline to fund the loan if the overall mortgage broker compensation is not reasonably related to the services performed or the goods and facilities provided by the mortgage broker;

d. refrain from providing, in exchange for the referral of business, those settlement services for which the mortgage brokers are receiving compensation; and

e. modify all its existing agreements with mortgage brokers within 60 days of the date of this Settlement Agreement to contain, and ensure that all future agreements with mortgage brokers contain, a provision that the mortgage brokers will make timely disclosures to borrowers concerning the broker's services and compensation, to the extent required by state law, and, within 60 days of the date of this Settlement Agreement, Delta shall provide further disclosure, in the form of Attachment A hereto (the "Broker Information Disclosure") to each borrower from whom Delta receives a loan application. Delta shall provide the Broker Information Disclosure no later than three business days after the loan application is received by Delta.

3. With respect to loans covered by HOEPA proposed by brokers, Delta shall:

a. reject the broker's proposal when it believes the broker's proffered documentation of the borrower's income is insufficient to support the amount of income claimed;

b. maintain loan underwriting standards designed to ensure that extensions of credit are based on the borrower's repayment ability including the borrower's

current and expected income, current obligations, and employment; and

c. maintain loan underwriting procedures designed to ensure that any borrower's income will be verified and documented to establish a reasonable basis to believe such income exists.

B. Notice to Mortgage Brokers Concerning Compliance With this Settlement Agreement

1. Within 60 days of the date of this Settlement Agreement, Delta shall notify each mortgage broker with which it does business of the compliance requirements set forth in paragraph IV.A, and shall revise the materials it provides to all brokers to include the following statements:

a. "The Fair Housing Act and the Equal Credit Opportunity Act apply to all aspects of the credit process including the pricing of mortgage loans;"

b. "It is unlawful to make differing initial price quotations on the basis of the loan applicant's race, national origin, sex, or age;"

c. "The Real Estate Settlement Procedures Act prohibits compensation to a mortgage broker unless the compensation is in exchange for services actually performed and goods and facilities actually furnished by the broker, and the mortgage broker's total compensation is reasonably related to the value of the services performed and the goods and facilities furnished by the broker;" and

d. "The Home Ownership and Equity Protection Act of 1994 prohibits the making of non-purchase money mortgage loans that

have total points and fees that exceed eight percent of the total loan amount without regard to the borrower's ability to repay. Accordingly, all loans subject to HOEPA must be supported by credible documentation that the borrower is able to repay the loan.

2. In addition, Delta shall offer all wholesale brokers with whom it does mortgage loan business the opportunity to undergo training similar to the training described in Section VII.

V. MONETARY COMPENSATION

On September 17, 1999, the Superintendent of Banks of New York State ("NYSBD") and Delta entered into a Remediation Agreement resolving NYSBD's allegations that its examination of Delta's lending practices revealed violations of the FHA, ECOA, RESPA and HOEPA and Section 296-a of the New York Executive Law. The settlement includes a $7,250,000.00 "Remediation Fund" by Delta and an "Amelioration Fund" consisting of 525,000 unregistered shares of common stock ("Stock") of Delta Financial Corporation. The "Remediation Fund" and the proceeds from the sale of the Stock in the "Amelioration Fund" shall be used to compensate borrowers identified by the NYSBD and the federal agencies.

One of the purposes of the Remediation Fund is to compensate New York State borrowers, including residents of minority areas and African American females identified by the Department of Justice and the NYSBD, who obtained home mortgage loans from Delta between October 1, 1995 and September 17, 1999 and who allegedly paid more for their loans than the average borrower who was a resident of non-minority areas or the average non-minority borrower, and New York State borrowers with respect to whom the NYSBD alleges Delta violated HOEPA or RESPA. Compensation will be

in the form of reductions to monthly mortgage payments on a going forward basis as set forth in the September 17, 1999 Remediation Agreement executed by the NYSBD and Delta.

The "Amelioration Fund" will be used to provide monetary restitution to borrowers who were allegedly harmed by Delta's alleged fair lending, RESPA, and/or HOEPA violations, as identified by the Department of Justice and the NYSBD. Restitution must be paid to all eligible New York State borrowers before restitution is made to borrowers outside New York State. Any borrower to whom compensation is awarded from the Remediation Fund or Amelioration Fund shall be required, prior to receiving any such compensation, to sign a general release.

VI. MONITORING AND COMPLIANCE SYSTEM

A. Within forty-five days of the date of this Settlement Agreement, Delta shall submit to the federal agencies for review and approval a new monitoring and compliance system designed to ensure uniform application of underwriting criteria and appropriate payment of mortgage broker fees. If the federal agencies do not otherwise notify Delta in writing within forty-five days after their receipt of the new monitoring and compliance system, it shall be deemed approved.

B. The monitoring and compliance system shall include:

1. Development and implementation of policies and guidelines designed to ensure that the underwriting of mortgage loans is made in compliance with law. Such guidelines shall be incorporated into Delta's lending policy;

2. Development and implementation of a system designed to accurately record data related to the charging of broker fees on mortgage loans underwritten, closed and funded by Delta, including the dollar and percentage amount of the broker fee charged, the amount and type

of loan, documentation of any pricing exceptions, information about the borrower as required by the Home Mortgage Disclosure Act ("HMDA"), the name of the loan officer, and the name of the mortgage broker;

3. Development and implementation of a comprehensive system designed to permit detailed periodic monitoring of mortgage origination pricing practices to ensure that flexible pricing does not result in discrimination and that mortgage broker compensation is in exchange for and is reasonably related to the services, goods, and facilities provided by the broker.

4. The development and implementation of a system designed to identify all borrowers whose loans are subject to the requirements of HOEPA and permit detailed and ongoing monitoring of file documentation that such borrowers are able to repay their loans.

5. The designation of managers, including senior-level managers, to serve as compliance officers and to monitor compliance with the foregoing compliance system; and

6. The development and implementation of a disciplinary policy for employees who violate the required policies and practices described in this Settlement Agreement.

VII. EDUCATION OF DELTA EMPLOYEES

A. Within forty-five days from the effective date of this Settlement Agreement, Delta shall amend its existing Fair Lending Training Program to include the elements set forth below, and shall submit the amended training program ("Amended Training Program") to the federal agencies for review and approval. If the federal agencies do not otherwise notify Delta in writing within forty-five days after their receipt of the Amended

Training Program, it shall be deemed approved. Such Amended Training Program shall include:

1. A detailed discussion of the purpose of, and the prohibitions contained in HOEPA, ECOA, FHA, and RESPA;
2. A detailed discussion of liability for violations of HOEPA, ECOA, FHA, and RESPA;
3. A certification form to be completed by each officer and employee attending the training program; and
4. A schedule pursuant to which the training program and supplemental training programs will be offered.

B. Within sixty days following the approval of the Amended Training Program by the federal agencies, all Delta officers and employees whose job responsibilities include contact with consumers or mortgage brokers concerning mortgage loan applications, the pricing of mortgage loans or the monitoring of mortgage pricing shall attend the Amended Training Program.

C. All new Delta officers and employees whose job responsibilities include contact with consumers or mortgage brokers concerning mortgage loan applications, the pricing of mortgage loans or the monitoring of mortgage pricing shall attend the Amended Training Program within forty-five days of their employment with Delta.

D. All Delta officers and employees attending the Amended Training Program shall execute a certification form stating that the individual has attended the Amended Training Program, that the individual understands Delta's policies regarding non-discrimination in the origination and underwriting of mortgage loans, that the individual understands Delta's disciplinary policies with respect to originating and underwriting mortgage loans and compliance with HOEPA, ECOA, FHA, and RESPA, and that the individual understands

that failure to comply with such laws may subject the individual and/or Delta to sanctions.

E. Delta shall comply with the training provisions described above in all states in which it does business; provided, however, that in states other than New York, Delta shall not be required to provide training in connection with laws that apply only in New York.

VIII. RECORDKEEPING AND REPORTING REQUIREMENTS

A. For a period of three years from the date of this Settlement Agreement, Delta agrees to retain all loan application files submitted for mortgage loans, all loan-related documents and notices relevant to any pricing decisions, and all documents related to compliance and monitoring as set forth in Section VI, above. During this period, upon reasonable notice from the Civil Rights Division of the United States Department of Justice ("DOJ"), Delta shall make individual mortgage loan application files and related records available for inspection or copying by the DOJ.

B. Delta agrees that it will periodically review its lending operations for compliance with the RESPA, FHA and ECOA.

C. For a period of three years from the date of this Settlement Agreement, Delta shall report its compliance with this Settlement Agreement to the DOJ semi-annually, beginning with the period ending September 30, 2000, within forty-five days after the end of each half-year period.[1] Each such report shall include:

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[1] All notices, correspondence, reports, or documents required to be provided to the United States shall be mailed to the following address:

Chief, Housing and Civil Enforcement Section
Civil Rights Division
U.S. Department of Justice
P.O. Box 65998
Washington, D.C. 20035

1. A report on Delta's fair lending pricing requirements; and
2. A description of corrective actions taken by Delta to comply with this Settlement Agreement.

IX. ADMINISTRATION OF SETTLEMENT AGREEMENT; MISCELLANEOUS

A. The Court shall retain jurisdiction for the purpose of enforcing the terms of this Settlement Agreement for a period of three years from the date it is entered by the Court, at which time this Settlement Agreement shall terminate. The Settlement Agreement shall be binding on Delta and any of its employees, representatives, officers, heirs, assigns, subsidiaries, or successors in interest.

B. The parties to this Settlement Agreement shall endeavor in good faith to resolve informally any differences regarding interpretation of and compliance with this Settlement Agreement prior to bringing such matters to the Court for resolution. Furthermore, the United States shall not bring any matter involving compliance with this Agreement to the Court for resolution unless it reasonably believes that Delta has materially violated the provisions of this Settlement Agreement. This Settlement Agreement may be modified by written consent of Delta and the federal agencies. Any such modification may be submitted to the Court for approval, and shall be deemed effective immediately upon execution by the parties until such time, if any, that the Court indicates a lack of such approval.

C. For purposes of measuring time periods, the "date of" this Settlement Agreement shall be deemed to be the date of its entry by the Court.

D. Each party to this Settlement Agreement will bear its own costs.

E. This Settlement Agreement, when fully executed and performed by Delta to the reasonable satisfaction of

the federal agencies, will resolve all the issues between Delta and its affiliates (including, without limitation, Delta Financial Corporation), and the United States respecting the subject matter of the United States' Complaint.

ATTACHMENT A

DELTA FUNDING CORPORATION
1000 WOODBURY ROAD
WOODBURY, NY 11797
800- 225-5335

BROKER INFORMATION DISCLOSURE

Date:

File:

Dear Customer:

The purpose of this disclosure is to provide you with an estimate of the fee you will be paying to your Mortgage Broker in connection with your loan. This disclosure does not include all fees you will pay for this loan. For that information please refer to the Good Faith Estimate of settlement costs that you already have or soon will receive, and the HUD-1 form that will be given to you at closing. The HUD-1 will show the final charges for broker and other fees.

Please read this information carefully so that you make an informed choice. You are entitled to a copy of this disclosure. Signing this disclosure does not obligate you to obtain the mortgage loan described below, nor does it constitute a mortgage loan approval.

We have received your application for a mortgage loan from ____(Name of Mortgage Broker).

1) The Mortgage Broker is expected to charge a total of $_____ for arranging a mortgage loan of $_____ at a proposed interest rate of ____%. This amount is made of:

a) $_____ paid by you to the Broker as a percentage of the loan; and

$_____ in additional amounts paid by you to the Broker as noted on the Good Faith Estimate. These amounts will be paid from the proceeds of your loan and/or directly out of your pocket; and

b) $_____ paid to the Broker by Delta Funding Corp. which increases your interest rate on the loan;

IF ANY PORTION OF THE BROKER FEE DESCRIBED ABOVE IS PAID FROM THE PROCEEDS OF THE LOAN, YOU WILL BE OBLIGATED TO REPAY THIS AMOUNT WITH INTEREST OVER THE TERM OF THE LOAN.

If you would rather pay a lower interest rate on your loan, you may be able to pay higher upfront fees. If you pay less upfront, you may pay a higher interest rate. If you have any questions about the different options available to you, your mortgage broker and/or Delta will be glad to discuss them with you.

2) The Broker's Fee described above is payable only if the loan is approved and accepted by you.

Please sign and return one copy in the enclosed envelope. Keep the other copy for your files.

_____ _____

(SIGNATURE) (DATE)

MADAM:

PLEASE TAKE NOTICE that the within will be presented for settlement and signature to the Clerk of the United States District Court in his office at the **UNITED STATES DISTRICT COURT** U.S. Courthouse, 225 Cadman Plaza East, **Eastern District of New York**, Brooklyn, New York, on the _____ day of_____, 19__, at 10:30 o'clock in the forenoon.

Dated: Brooklyn New York,

_____, 19____

_____

United States Attorney,

Attorney for _____

To:

_____

_____

Attorney for _____

MADAM:

PLEASE TAKE NOTICE that the within is a true copy of _____ duly entered herein on the _____ day of _____, in the office of the Clerk of the Eastern District of New York,

Dated: Brooklyn New York,

_____, 19_____

United States Attorney,
Attorney for _____

To:

_____

_____

_____

Attorney for _____

Civil Action No. CV

UNITED STATES DISTRICT COURT
Eastern District of New York

UNITED STATES,

Plaintiff,

- against -

DELTA FUNDING CORPORATION AND DELTA FINANCIAL CORPORATION,

Defendants.

SETTLEMENT AGREEMENT AND ORDER

LORETTA E. LYNCH

United States Attorney,
Attorney for United States
Office and Post Office Address,
One Pierrepont Plaza, 16th Floor
Brooklyn, New York 11201
By: MARLA TEPPER, AUSA
(718) 254-6155

Due service of a copy of the within _____ is hereby admitted.

Dated: _____, 19__

Attorney for _____

CIVIL RIGHTS LITIGATION

APPENDIX N

Hearing on "Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums" Before the Senate Committee on Banking, Housing, and Urban Affairs, 107th Congress (9:30 a.m., Tuesday, January 8, 2002 – Dirksen 538)

Prepared Statement of Prof. Howell E. Jackson Finn M.W. Caspersen and Household International Professor of Law and Associate Dean for Research and Special Programs Harvard Law School

Chairman Sarbanes and Members of the Committee:

I am very pleased to be here today to discuss the problem of yield spread premiums and the Department of Housing and Urban Development's recent Statement of Policy 2001-1, 66 Fed. Reg. 53,052 (Oct. 18, 2001) ("Policy Statement"). Yield spread premiums and related industry practices have become a major problem for American homeowners. Payments of this sort are inherently confusing and serve primarily to raise the cost of home ownership for many Americans, particularly the less educated and the financially unsophisticated, by billions of dollars a year. In my opinion, yield spread premiums represent the sort of sharp practices that Congress sought to prohibit when it enacted the Real Estate Settlement Procedures Act of 1974 (RESPA) more than twenty five years ago. I urge both Congress and the Department of Housing and Urban Development to redouble their efforts to eliminate the substantial and widespread consumer abuses that yield spread premiums have visited upon American homeowners in recent years.

Introduction

Over the past year, I have been investigating the economic impact of yield spread premiums.[1] A major component of my investigation has been an empirical analysis of a nationwide sample of approximately 3,000 mortgages originated by one group of affiliated lending institutions in the late 1990s. This study constitutes the most extensive empirical investigation of yield spread premiums to-date. In my testimony before the Committee this morning, I would like first to discuss the implications of my study for the Department's Policy Statement and then to propose a number of specific actions I believe the Department should take to prevent abusive uses of yield spread premiums in the future.

The Policy Statement

Let me begin by commending the Department for its willingness to take on an issue as complex as the payment of yield spread premiums. While my analysis of these practices differs from the Department's views in many important respects, I wholeheartedly agree with the Department's initial premise and the premise of the RESPA itself: that real estate settlement practices are an area in which governmental intervention is necessary both to protect consumers and to ensure the efficient operation of market forces.

My comments about the Policy Statement are divided into two parts. First, I will discuss the statement's factual assumptions about the role of yield spread premiums in today's mortgage market. Second, I will comment on several aspects of the Department's legal

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[1] I initially undertook this project as an expert for the plaintiff class in Glover v. Standard Federal Bank, Civil No. 97-2068 (DWF/SRN) (U.S. District Court, District Court of Minnesota) (pending) and am currently expanding the study into an academic article, the current draft of which is attached to this testimony: Howell E. Jackson & Jeremy Berry, Kickbacks or Compensation: The Case of Yield Spread Premiums (Jan. 8, 2002) (hereinafter "Jackson & Berry") [a abridged draft of this paper is available at http://www.law.harvard.edu/faculty/hjackson.

analysis of how section 8 of RESPA, which prohibits certain kickbacks and unearned referral fees, should be applied to the payment of yield spread premiums.

A. Factual Assumptions about the Role of Yield Spread Premiums

As explained in the Policy Statement, the Department conceives of yield spread premiums as a valuable "option" that "permits homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate."[2] This method of financing up front settlement costs, according to the Department, is particularly suited to borrowers who are low on cash and "whose loan to value ratio has already reached the maximum permitted by the lender.[3] Based on these factual assumptions, the Department concludes that the yield spread premium is a "legitimate tool to assist the borrower" and a financing option that "fosters home ownership."[4]

As a purely theoretical matter, the Department's assumptions about the role of yield spread premiums are plausible. Homeowners who are short on cash could, theoretically, use yield spread premiums to finance settlement costs. My study, however, offers compelling evidence that yield spread premiums are not being used in this way.[5] Rather, the manner in which yield spread

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[2] 66 Fed. Reg. at 53,054.

[3] *Id.*

[4] *Id.*

[5] As indicated above, the sample upon which my empirical study is based was limited to loans originated by an affiliated group of lending institutions and thus does not include loans from all lending institutions in the industry. It is possible that the abusive practices uncovered in my study are peculiar to the lending institutions included in my sample. However, I doubt that this is the case. Industry experts have opined that the practices of the lenders in my study "are typical of other wholesale lenders." See Report of David Olson, Glover v. Standard Federal Bank, Civ. No. 97-2068 (DWR/SRN) (U.S. District Court, District Court of Minn.) (filed June 24, 2001) (expert for defendants). At a minimum, the evidence uncovered in my study should put the burden on the Depart-

premiums are levied combined with the complex structure of real estate settlement procedures serves principally to allow mortgage brokers to impose higher prices on borrowers who bear the cost of these charges – particularly on individuals who are less educated and less sophisticated about financial matters. This abusive form of price discrimination substantially increases the overall costs to borrowers, thereby imposing a hidden tax on home ownership for many Americans.

1. Yield Spread Premiums Are Not Currently Presented to Consumers as an Optional Way to Finance Settlement Costs. An initial problem with the Department's understanding of yield spread premiums is its notion that these payments represent an option that consumers voluntarily choose. Consumers are given no such choice. Mortgage brokers, in my experience, never describe yield spread premiums as an optional method for financing settlement costs, nor do the Department's own consumer publications or the most popular consumer guides for buying a home. What is more, consumers are never given the sort of advice they would need to make a meaningful comparison between the cost of higher interest rates over the life of a loan and direct cash payments for closing costs.[6] Rather, borrowers are

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ment to demonstrate with comparable evidence that the factual assumptions underlying the Policy Statement are accurate for the industry generally.

[6] What HUD regulations do require is "disclosure" of yield spread premiums. However, this disclosure is inadequate in many respects. Yield spread premiums are not reported in a consistent manner in HUD-1 forms; often times they appear on back pages of the form and sometimes in a smaller font. Most important, these payments are almost always denominated "p.o.c. by lender," meaning that they are "paid outside of closing by the lender." It is inconceivable that more than a tiny fraction of consumers can correctly evaluate this information. For a more complete discussion of the problems consumers face in deciphering this information, see Jackson & Berry, *supra* note 1, at 2-5, 51-65.

One measure of inadequacy of current disclosure practices is the difficulty my assistants had even finding the amount of yield spread premiums on HUD-1 forms. Even after receiving explicit training on the

simply told that their loans will have a certain interest rate, and they never understand that the interest rate is higher than it needs to be or that the higher interest rate is used to finance a payment to the mortgage broker.

2. Incidence and Magnitude of Yield Spread Premiums Are Extremely High. Another erroneous factual assumption implicit in the Policy Statement is the notion that yield spread premiums are paid by a relatively small number of borrowers who lack adequate resources to pay closing costs directly. To the contrary, my study indicates that the vast majority of borrowers pay yield spread premiums – on the order of 85 to 90 percent of all transactions.[7] Moreover, the average amount of yield spread premiums is quite substantial, on the order of $1,850 per transaction, making these payments the most important single source of revenue for mortgage brokers.[8] In other words, contrary to the Department's assumptions, yield spread premiums are not an "optional" form of financing made available to a limited number of borrowers with special needs. Rather these payments constitute by far the largest source of compensation for mortgage brokers and are imposed on almost all borrowers who obtain mortgages or refinancings through this segment of the industry.

3. Most Borrowers with Yield Spread Do Not Need Extra Financing. Another fallacy in the Department's factual assumption is its suggestion that borrowers who pay yield spread premiums have no other means of paying closing costs. This assumption is clearly wrong. According to my analysis, more than three-quarters of the borrowers who were charged yield spread premiums had

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subject, a team of paralegals and certified public accountants was only able to find yield spread premiums on about two-thirds of the forms on which the payments were supposedly disclosed. See Jackson & Berry, *supra* note 1, at 71-74 & n.112.

[7] See Jackson & Berry, *supra* note 1, at 73 (Table 2).

[8] *Id.* at 78-81.

loans that were less than the defendant lending institutions' maximum loan-to-value ratios and therefore could easily have financed closing costs by increasing the amount of their loans.[9] In other words, most borrowers who are charged yield spread premiums do not need an extra (and exorbitantly costly) form of financing for their closing costs.

4. Mortgage Brokers Earn on Average $1046 more on Loans with Yield Spread Premiums. Another erroneous premise of the Policy Statement is that industry offers yield spread premiums as a service to their customers and is indifferent to whether consumers pay closing costs directly or through the imposition of yield spread premiums. Mortgage brokers clearly much prefer making loans with yield spread premiums. According to my study, mortgage brokers made an average of $1,046 more on loans with yield spread premiums than they did on comparable loans unaffected by these practices.[10] Thus, on average, borrowers who get loans with yield spread premiums pay their mortgage brokers over a thousand dollars more than other borrowers. This substantial difference, in my view, goes a long way to explain why the industry has so zealously resisted efforts to police the payment of yield spread premiums, and it clearly refutes the Department's premise that yield spread premiums are just another form of payment.[11]

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[9] *Id.* at 147 & n. 180. My study did not consider other sources of funding, such as cash reserves or credit cards or loans from family members. Were these and other alternative sources considered, even more borrowers would have had viable financing options other than paying yield spread premiums. As explained below, the true costs of yield spread premiums are so high that a borrower would be well advised to employ almost any other form of financing.

[10] *Id.* at 91-97 (Figure 14).

[11] Why mortgage brokers can earn more money on loans with yield spread premiums is an interesting and important academic question. I explore this issue in considerable detail in my academic writings on the subject. In brief, I believe a number of factors are at work. In this context, consumers are primarily concerned with buying homes and being approved for financings; thus, they spend less time monitoring the

5. On Average, Seventy-Five Percent of Yield Spread Premiums Goes to Mortgage Brokers. The most critical error in the Policy Statement is its assumption that mortgage brokers use yield spread premiums to "recoup the upfront costs incurred on the borrower's behalf."[12] In my study, I employed a variety of statistical techniques to explore the relationship between yield spread premiums and direct cash payments to mortgage brokers. With the highest degree of statistical confidence, my studies refute the proposition that borrowers receive a dollar for dollar offset for yield spread premiums.[13] My best estimate is that borrowers, on average, enjoy 25 cents of benefit for each dollar paid in yield spread premiums.[14] In other words, the vast majority of yield spread premiums – on the order of seventy-five percent – serve only to increase the compensation of mortgage brokers. Contrary to the Department's assumptions, consumers do not, by a long stretch, recoup the costs of yield spread premiums.

6. Characterized as a From of Financing, Yield Spread Premiums Are Usurious. As explained above, I do not believe that yield spread premiums are actually being offered to borrowers as a form of financing upfront costs.[15] However, if one were to accept this characterization and then attempt to estimate the cost of this sort of financing, the implicit interest rates are absolutely outrageous. For an average borrower in my study, the

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comparatively smaller costs associated with real estate settlement. In addition, they trust their mortgage brokers to recommend appropriate financing terms and cannot easily police these recommendations. In addition, consumers have difficulty calculating costs of higher monthly payments as compared with direct cash payments and are not protected by market forces because these side payments allow brokers to discriminate among sophisticated an unsophisticated consumers and avoid creation of a single market price for settlement services. See *id.* at 51-65.

[12] 66 Fed. Reg. at 53,054.

[13] Jackson & Berry, *supra* note 1, at 102-16.

[14] *Id.*

[15] See *supra* text accompanying note 6.

implicit interest rate on a "yield spread premium loan" to finance closing costs would be in excess of 114 percent per year – on the order of ten times higher than a typical credit card interest rate.[16] Had the Department been aware of the true costs of this sort of financing when it prepared its Policy Statement, I expect it would have approached the problem in a very different manner.

7. African Americans and Hispanics Pay Much More for Mortgage Broker Services. While my study suggests that yield spread premiums are a very bad deal for average consumers, I believe these practices are particularly injurious to the least sophisticated members of society – groups of which the Department has historically been most protective. To test this hypothesis, I also examined the relationship between mortgage broker compensation and the racial identity of borrowers. The results indicated that mortgage brokers charged two racial groups – African-Americans and Hispanics – substantially more for settlement services than they did other borrowers. For African-Americans, the average additional charge was $474 per loan, and for Hispanics, the average additional charge was $580 per loan.[17] While I expect to do more work on this aspect of my analysis, these preliminary results are consistent with my hypothesis that current industry practices allow mortgage brokers to exploit less sophisticated borrowers by imposing higher charges.

B. Legal Analysis Proposed in the Policy Statement

The Department's misapprehension of the true economic impact of yield spread premiums has substantial implications for the Policy Statement's legal analysis. Had the Department understood how disadvantageous yield spread premiums are for most consumers, the agency

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[16] Jackson & Berry, *supra* note 1, at 144-47.

[17] *Id.* at 120-26. This analysis controls for a variety of factors, including principal loan characteristics, credit quality of borrower, loan-to-value ratios, and certain geographic variables.

would, I believe, have proposed that the payments be treated very differently under the two-step test used to determine whether particular payments are prohibited under section 8 of RESPA.[18]

1. Payment of Yield Spread Premiums Could Run Afoul of the First Step of HUD's Test. In its Policy Statement, the Department summarily concludes that yield spread premiums are paid for "good or services" and thus reasons that the payments passed the first step of the Department's test. If one accepts the Department's factual assumptions – that yield spread premiums are a bona fide option for financing closing costs and that the payments are in fact recouped through offsetting reductions in closing costs – this conclusion would be understandable. However, if instead one credits the findings of my study – that the yield spread premiums serve primarily to increase payments to mortgage brokers and not to lower the up front costs of borrowers – the legality of the payments under step one of the HUD test is far from clear. As explained above, my study suggests that only a fraction of each dollar of yield spread premiums goes to financing goods and services. Under these circumstances, I believe that it is more accurate to characterize the payment of yield spread premiums as *not* being a bona fide payment for goods and services. Under this view, the practice runs afoul the first step of the Department's test for legality.

2. Allowing Payments of this Sort to Escape Liability Under Step One Does Not Square with the Congressional Policies Underlying Section 8 of RESPA. The alternative approach – that is, allowing settlement service

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[18] In an earlier statement of policy, the Department proposed this two-step test. Under the first step, courts are to consider whether a particular payment is made for "goods and services actually furnished or services actually performed." If the answer to this question is no, then liability is attached; if the answer is no, then the court must proceed to the second step of the test, under which it must determine whether the amount of the payment was reasonably related to the goods and services provided. See HUD Statement of Policy 1999-1, 64 Fed. Reg. 10,080 (Mar. 1, 1999).

providers to escape liability under step one as long as the providers could show they contributed some value to the transaction – flies in the face of the legislative history that preceded the passage of RESPA. In the early 1970s, real estate settlements were plagued by kickbacks and referral fees. Typically, a firm with substantial influence over the settlement – for example an attorney or a real estate agent – would demand side-payments from other service providers, such as title insurance companies, as a quid pro quo for recommending the service provider to perform the transaction. It was these referral fees that Congress sought to outlaw with section 8 of the RESPA, principally because Congress believed these transactions increased the overall cost of home ownership.[19] Were the Department to adopt the position that recipients of kick-backs have a defense from section 8 liability if they can demonstrate that they provided some other good or service for the transaction, it would seem to have created a major loophole for just the kinds of sharp practices that the provision was designed to eliminate. After all, almost all of the recipients of kickbacks that motivated the passage of the act also performed some level of service for the settlement transactions in question. Certainly, where statistical evidence demonstrates that the payments in question (here yield spread premiums) serve substantially – indeed primarily – to increase the cost of home ownership, the activity should be proscribed under section 8.

3. Inappropriateness of Individualized Adjudication of Reasonableness. A further difficulty with the Department's legal analysis is its apparent willingness to have the courts determine the reasonableness of yield spread premiums on a case-by-case basis. As this aspect of the Policy Statement concerns a matter of judicial management, it is a matter that the courts themselves will have to resolve. But, on multiple dimensions, individualized determinations of reasonableness of the sort the Depart-

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[19] *Id.* at 9-23.

ment appears to favor would be problematic. To begin with, in order to measure the impact of yield spread premiums for a particular borrower, a court must consider the impact of the payments in a large number of cases, as I did in my study. As is well-developed in other areas of the law – ranging from disparate impact cases to securities litigation – it is impossible to assess the reasonableness of one borrower's payments in a vacuum. For both litigants and courts, it would be an inefficient use of resources to repeat this analysis on a transaction by transaction basis. In addition, the Department's approach invites the sort of judicial rate regulation that Congress expressly rejected when it enacted RESPA more than twenty-five years ago. In the early 1970s, many recommended rate-making procedures for real estate settlement services, but Congress chose instead to police the industry through a combination of disclosure rules and the liability provisions of section 8. The Policy Statement threatens to resurrect judicial rate regulation as the principal mechanism for controlling kickbacks in the real estate settlement field. Arguably, under the Department's approach, a section 8 plaintiff would be forced to sustain the costs of a hearing on reasonableness whenever a defendant demonstrates that it provided any goods or services in connection with a settlement. In my view, this approach subverts the intentions of Congress and leaves consumers inadequately protected from predatory practices, such as the payment of yield spread premiums. Moreover, the approach seems to relieve from liability many of the abusive practices that Congress intended to outlaw with the enactment of section 8.

Proposals for Prospective Relief

One of the most heartening aspects of the Policy Statement is the Department's willingness to propose changes in the disclosure rules regarding yield spread premiums and related practices. In my view, reforms in this vein could go a long way toward protecting consumers and improving the efficiency of the market in this area. In

particular, I would recommend the following specific changes.

1. Requiring Disclosure of Par Rate Loan Option. One of the principal sources of confusion underlying yield spread premiums is that most consumers are not aware that when they are offered an above par loan (on which a yield spread premium is paid), they almost always have the option of receiving a par rate loan with a lower interest rate and lower monthly payments. Whenever a mortgage broker proposes an above par loan, the Department should therefore require the broker to offer the borrower a comparable loan with a par interest rate. By offering consumers both types of loans, mortgage brokers would make clear that above par loans (and yield spread premiums) are simply one option for home financing.[20] Requiring such offerings would also encourage both the Department and independent consumer groups to educate consumers about the pros and cons of the two options.

2. Direct Payment of Yield Spread Premiums to Consumers (on line 200). Whenever a mortgage broker presents a good faith estimate or a HUD-1 form for an above par loan, the full amount of the yield spread premium should be paid directly to the borrower in the form of a credit on line 200. If yield spread premiums are to become a legitimate form of financing, the proceeds of the financing must always be given to the borrower. Then, the borrower can decide how to use those funds – whether to pay for closing costs or some other purpose. A further advantage of this reform is that it will force mortgage brokers to provide borrowers with a full accounting of their costs elsewhere on the form. Under the current rules, brokers use yield spread premiums to disguise their true levels of compensation. Not only is the current practice inherently deceptive; it also makes

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[20] Brokers might also be required to disclose the rate sheet associated with the pricing of their loans. This would provide more information than most consumers would need but could be useful to consumer groups and the financial press.

it all but impossible for consumers to compare the true costs of loans from different brokers and other lenders.

3. Prohibition on Discount Points Paid to Brokers. A further practice that should be eliminated is the payment of discount points to mortgage brokers. Traditionally, consumers pay discount points to lenders in order to obtain a below par loan – that is, a loan with an interest rate below the rate on a comparable par loan. Under current HUD regulations, however, mortgage brokers are also permitted to charge discount points "to lower" the interest rate of a loan. In my study, I discovered that mortgage brokers were routinely charging discount points, even on par and above par loans.[21] This practice is inherently deceptive. The only way a mortgage broker can "lower" the interest rate on such loans is to start by offering the borrower an above par rate. In this context, the payment of discount fees to mortgage brokers simply serves to convert a yield spread premium into a direct up-front cost for the borrower.[22] In my view, the term "discount fees" should be limited to payments made to the lending institution that are actually used to lower a par rate loan into a below par loan.

4. Comparable Reforms for Direct Lenders. A final area of regulatory reform concerns the development of comparable disclosure requirements for direct lenders. Representatives of mortgage brokers occasionally defend current disclosure practices on the grounds that reforms of the sort outlined above would put mortgage brokers at a disadvantage to direct lenders. The Department, I believe, should reject claims of this sort. To begin with, mortgage brokers have become the leading source of

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[21] The incidence of discount fees to mortgage brokers ranged from 10 percent to 47 percent, depending on the sample, and averaged between $744 and $1,335. See *id.* at 77 (Table 4).

[22] Not only does this practice needlessly complicate the true compensation of mortgage brokers; it also belies claims that above par loans are being used to lower up front costs for consumers. How could a consumer rationally request an above par loan for this reason and then pay an up front discount fee to turn the loan back into a par loan?

home mortgages in the United States. It is imperative that the Department correct disclosure practices for this dominant segment of the industry. To allow issues associated with other sectors of the industry to stand in the way of such reforms would be letting the tail wag the dog. Still, I agree with those who say that disclosure reforms for direct lenders are also appropriate. After all, when direct lenders charge above par rates and then resell their loans in the secondary market, they receive implicit yield spread premiums. The solution to this problem, I believe, is to require direct lenders to credit borrowers with an implicit yield spread premiums similar to the ones to be required for mortgage brokers. For direct lenders who actively participate in the wholesale purchase of loans, the appropriate par rates could be derived from the institution's contemporaneous rate sheets. For other direct lenders, the Department might maintain and keep current a national listing of averages of par rates for various categories of loans, derived from the contemporaneous rates sheets of leading wholesalers. The Department would have to work out the details of such a proposal, but the concept is well within the agency's expertise.

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Let me conclude by again commending the Department for taking on this issue. I would be delighted to work with the Department as it moves forward in this area, and would welcome any questions that members of the Committee have.

APPENDIX O

HOWELL E. JACKSON
Finn M. W. Caspersen and Household International Professor of Law and Associate Dean for Research and Special Programs
[contact information omitted]

February 7, 2002

Senator Paul S. Sarbanes
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510-6075

Re: Supplemental Questions from January 8, 2002, Hearing on Predatory Lending Practices: Abusive Uses of Yield Spread Premiums

Dear Senator Sarbanes:

In response to your letter of January 14, 2002, I have prepared answers to the supplemental questions that you and Senator Schumer posed. I have also appended a brief response to the Statement of ABN AMRO Mortgage Group regarding my initial testimony.

If you or your staff has any further questions about these issues, I would be delighted to provide your committee with additional information.

Sincerely,

/s/ Howell E. Jackson
Howell E. Jackson

Finn M.W. Caspersen and
Household International
Professor of Law

Supplemental Responses of Professor Howell E. Jackson

February 7, 2002

Questions and Responses of Professor Howell E. Jackson

1. During the hearing, Mr. Olson said that the mortgage brokerage business "isn't very profitable." Do you have any information on the profitability of the mortgage broker industry?

While I have not undertaken an independent investigation of the profitability of the mortgage brokerage business, I have reviewed several reports on the subject that Mr. Olson himself prepared. Contrary to Mr. Olson's testimony at the hearing, these reports indicate that mortgage brokers have been extremely profitable in the past decade and, in particular, during the 1996-2000 period during which the sample loans in my study were originated.

To begin with, consider the growth of mortgage brokers. According to Mr. Olson's Wholesale Access Report: Mortgage Brokers 1998 (published in 1999), the industry grew dramatically during the 1990's:

> "There were about 36,000 mortgage brokers in the U.S. in 1998, up from 14,000 in 1991 and 31,000 in 1997. There was a 14.5% average annual rate of growth in the number of brokers from 1991 to 1998, which is parallel to the 15% average annual growth in originations over the same period." (Page 1)

Without any further information, I would be skeptical of any claims that an industry experiencing such a sustained rate of growth "isn't very profitable." If the industry were not profitable, why would so many new firms have been established during the last decade? However, one does not have to rely on inferences to assess the profitability of mortgage brokers in the 1990's. Mr. Olson's report directly addresses the issue:

> "The median broker produced $20 million, had 5 employees, produced 200 loans, earned $2,000 gross per loan, for a total revenue of $400,000 per firm. In 1991, the median broker produced $15 million with 5 employees." (Page 1)

So, while the number of mortgage brokers more than doubled between 1991 and 1998, the level of originations of the median firm also increased by a third.

Finally, Mr. Olson's report offers the following evaluation of the profitability of the mortgage brokerage business in 1998:

> "The median broker earned $2,000 gross income/loan for 200 loans, which means gross revenue of $400,000 (Table 94). The mean broker earned $2,443 gross income/loan for 325 loans, which means gross revenue of $794,000. Median expenses were $240,000, for a net profit of $160,000 (40%). The mean broker earned a profit of $203,000 on $794,000 (26%). Our study covering 1992 shows a median profit of $100,000 on revenue of $400,000. *This suggests a higher rate of profit in 1998 than earlier.* Since brokers are rarely C Corporations, they don't pay a corporate profits tax. They do however pay taxes at their lower personal rate. This suggests a total profit by brokers of $7.3 billion (36,000 x $203,000) before taxes. This exceeds the amount earned by the two federal agencies combined and much of the rest of the mortgage industry." (Page 14) (emphasis added).

As the median firm operates as a sole proprietorship, Mr. Olson's report suggests that a typical mortgage broker earned $160,000 in 1998 – an extraordinary median level of income for an industry that does not require substantial training or advanced degrees.

Last year, Mr. Olson issued an updated Whole Access Report: Mortgage Brokers 2000 (published in 2001). In connection with litigation for which I am serving as an expert witness for the plaintiff class, I have reviewed a

copy of this more recent report. However, the 2000 report was supplied to me under conditions of confidentiality and I am not free to reveal to the Committee the detail of Mr. Olson's more recent work. I can, however, provide the Committee my overall assessment of the 2000 Report. While there have been some changes in the structure and earnings of mortgage brokers since 1998, I am highly confident that Mr. Olson would concur in my opinion that there is little in this more recent report to suggest that mortgage brokering does not remain a profitable enterprise.

2. In your view, is the 2001 HUD "clarification" consistent with the law, and should the courts give it deference?

In the 2001 Policy Statement, 66 Fed. Reg. 53,052 (Oct. 18, 2001), the Department proposes a legal standard to determine when the payment of yield spread premiums violates Section 8 of RESPA. Under the Department's approach, a yield spread premium constitutes a per se violation of section 8 only if the mortgage broker receiving the payment provides no goods or services in connection with the transaction. If the mortgage broker does provide either such goods or services, then the payment is legal unless the borrower can demonstrate that the broker's total compensation was unreasonable. Reasonableness, under the Department's Policy Statement, is be determined on a case-by-case basis and not (by implication) in a class action lawsuit.

In my testimony before the Committee I questioned the factual assumptions underlying the Department's 2001 Policy Statement.[1] I also have serious questions

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[1] As I explained in my testimony, an initial problem with the Policy Statement is the Department's factual assumptions that yield spread premiums are simply an alternative source of financing for closing costs used by a discrete group of borrowers who cannot afford to pay those costs directly. My own study of yield spread premiums suggests that these payments are being imposed much more broadly and that bor-

about the Policy Statement's fidelity to the statutory language of section 8 of RESPA. In my view, there are three principal difficulties in the Department's legal analysis.

A. The Policy Statement Appears to Create a Loophole for the Market Abuses that Congress Clearly Intended for Section 8 to Eradicate. In the legislative process leading up to the original passage of RESPA in 1974, Congress was confronted with substantial evidence that real estate professionals, such as lawyers and real estate agents, were using their influence over real estate transactions to extract kickbacks from title insurance companies and other settlement service providers. Concluding that such payments were inherently unfair and needlessly increased the cost of home ownership, Congress adopted Section 8 to outlaw these practices. A major difficulty with the Department's 2001 Policy Statement is that it appears to create a substantial defense for precisely the practices that Congress intended to prohibit with Section 8. All of the recipients of these pre-RESPA kickbacks provided some sort of good or service for the transaction in question and also received other sources of compensation for their services. The Department's new Policy Statement would, as best as I can tell, permit the payments of kickbacks in real estate settlements unless the recipient of the kickback could show that its total compensation (including the kickback) was not was unreasonable. Such solicitude for the payment of kickbacks is wholly inconsistent with Congress's purpose in enacting Section 8 of RESPA.

B. The Department's 2001 Policy Statement Establishes a Regime of De Facto Rate Regulation

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rowers who incur these hidden charges end up paying their mortgage brokers much more – on the order of $1000 more – than do borrowers with comparable loans unaffected by yield spread premiums. The Department's misunderstanding of the true role of yield spread premiums further weakens the legal basis of the Policy Statement.

for Mortgage Services in Direct Contradiction of Congressional Intent. When adopting RESPA in 1974, Congress expressly rejected proposals to establish a national system of rate regulation for real estate settlement services and chose instead a combination of prohibitions, such as Section 8, and disclosure requirements. With its 2001 Policy Statement, the Department effectively repeals this congressional choice. As I read the Policy Statement, courts would be called upon to evaluate the legality of most kickbacks and referral fees based on the reasonableness of the total compensation of the recipient. While the Department does not delineate the precise contours of this reasonableness standard, the courts would presumably have to consider a kickback recipient's total costs, figure in reasonable rates of return on investment, and come up with an overall reasonable price for the recipient's goods and services in light of contemporaneous market prices for other comparable goods and services. Congress clearly did not want a federal administrative agency to engage in this sort of rate regulation, and I am highly doubtful that it would have intended for the courts to play such a role.

C. The Policy Statement Gratuitously Intrudes Upon Judicial Functions. A further problem with the 2001 Policy Statement is its gratuitous intrusion into the management of judicial cases. In an apparent effort to influence the certification of plaintiff classes in pending cases, the 2001 Policy Statement includes language suggesting that "it is necessary to look at each transaction individually" and that reasonableness depends on an evaluation of factors that can only be considered on a case-by-case basis. This analysis strikes me as misguided and inconsistent with prevailing judicial practices. First of all, reasonableness in a particularly case can only be determined in comparison to a broader category. Of necessity, therefore, litigation over yield spread premiums will involve consideration of a large number

of transactions. And the best way to determine whether loans with yield spread premiums entail unreasonable compensation to mortgage brokers is to compare samples of loans with yield spread premiums to samples without yield spread premiums.[2] To require repeated analysis of this sort in host of individual cases strikes me as a highly wasteful use of judicial resources. Moreover, the Department's approach seems to confuse the question of how much individual borrowers were injured through the payment of illegal kickbacks – something that might well vary from transaction to transaction and thus potentially influence the amount of damages – with the question of underlying liability. In many areas of the law, courts determine liability on a class-wide basis and then base damage awards on individualized determinations. Whether class certification would also be appropriate for civil suits challenging yield spread premiums under Section 8 of RESPA strikes me as a matter for the court, not an administrative agency, to resolve.

How much deference the federal courts should accord the Department's 2001 Policy Statement is an important question that I did not address in my testimony before the Committee and that I will only briefly touch upon in this supplemental statement. As described above, I believe there are serious inconsistencies between the 2001 Policy Statement and the congressional purposes in enacting Section 8 of RESPA. To the extent that the courts agree with my analysis of these issues, the Policy Statement would be subject to diminished deference even under the high standards that the Supreme Court set forth in *Chevron U.S.A. Inc.* v. *NaturalResources Defense Council*, 467 U.S. 837 (1984). Just last year, however, the Supreme Court narrowed the scope of the

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[2] In the litigation in which I am serving as an expert witness, experts for both sides – defendants as well as plaintiffs – used this sort of statistical analysis to evaluate the impact of yield spread premiums on mortgage broker compensation.

Chevron doctrine by holding that when an agency interpretation is not the product of either formal adjudication or notice- and-comment rulemaking, the *Chevron* deference standards may not even apply. See *United States* v. *Mead Corp.*, 533 U.S. 218 (2001). While the implications of the Court's recent ruling remain to be determined, I think it is fair to say the decision reduces the degree of deference that federal courts are likely to show interpretative rulings such as the Department's 2001 Policy Statement. Particularly to the extent that the Policy Statement purports to dictate the manner in which the judiciary should manage class certification procedures, judicial deference to the agency's view should be modest. See *Adams Fruit Co.* v. *Barrett*, 494 U.S. 638 (1990) (inappropriate for courts to consult executive interpretations to resolve ambiguities in the scope of a judicially enforceable remedy).

3. Currently, when individuals apply for loan assistance or a home mortgage, they are unaware of their credit scoring, and are therefore, under the Fair Credit Reporting Act (FCRA), vulnerable to acts of predatory lending including taking on a mortgage with a high-interest rate even though their credit score may qualify them for a low-interest loan. I think this is a serious issue, and Senator Allard and I have introduced the Consumer Credit Score Disclosure Act of 2001, which amends the FCRA to provide the consumer with a copy of: (1) the information obtained from a consumer reporting agency or that was developed and used by that user of the credit score information; or (2) a copy of the information provided to the user by a third party that developed the credit score, plus a general description of credit scores, their use, and the sources and kinds of data used to generate credit scores.

As an expert testifying before the committee, would you agree, that individuals should have access to their credit score in order to protect themselves from acts of predatory lending?

Yes. I agree that it would be useful for consumers to be given access to their credit scores. In addition, as I indicated in my testimony, I think consumers should also be provided information regarding the range of loans – including par value loans – available to borrowers with their credit scores. In addition to improving the fairness of loan transactions, disclosures of this sort would allow consumer groups and the financial press to provide better guidance to borrowers and thereby enhance the overall operations of credit markets.

* * * * *

Response to the Statement of ABN AMRO Mortgage Group

Following the Committee's Hearing of January 8, 2002, ABN AMRO Mortgage Group filed a statement disagreeing with certain aspects of my testimony and appending statements by two expert witnesses retained by defendants in the *Glover* v. *Standard Federal Bank* litigation in which I am serving as an expert for the plaintiffs. Having reviewed these materials, I remain confident that my testimony before the Committee presents an accurate picture of the abusive nature of yield spread premiums, that these payments impose substantial additional costs on consumers, and that the reforms I advocated for HUD-1 disclosures are fully warranted.

InterFirst

a division of Standard Federal Bank

777 E. Eisenhower Parkway, Suite 700, Ann Arbor, Michigan 48108-3258 800-542-5512 313-741-5100

InterFirst

FIXED RATES

30 YEAR FIXED - Program 100

(25 year amortization available.)	Rate	15 Day	30 Day	45 Day	60 Day
	9.250	103.000	102.375	102.250	102.125
	9.375	102.875	102.750	102.625	102.500
Conventional - Conforming	9.500	102.625	102.500	102.375	102.250
	9.625	102.375	102.250	102.125	102.000
	9.750	102.000	101.875	101.750	101.625
	9.875	101.875	101.750	101.625	101.500
	9.750	101.125	101.000	100.875	100.750
25 BONUS $100,000 + (includes all Community Home Buyers programs)	9.625	100.875	100.750	100.625	100.500
	9.500	100.500	100.375	100.250	100.125
	9.375	99.750	99.625	99.500	99.375
	9.250	99.375	99.250	99.125	99.000
	9.125	99.000	98.875	98.750	98.625
	9.000	98.375	98.250	98.125	98.000
	7.875	97.625	97.500	97.375	97.250
	7.750	97.125	97.000	96.875	96.750
	7.625	96.500	96.375	96.250	96.125

AFFORDABLE GOLD PREM PRICING - Program 100

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	9.750	104.250	104.125	104.000	103.875

20 YEAR FIXED - Program 120

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	9.250	102.375	102.250	102.125	102.000
	9.500	101.875	101.750	101.625	101.500
	9.750	101.625	101.500	101.375	101.250
25 BONUS $100,000 +	9.500	100.875	100.750	100.625	100.500
	9.250	100.125	100.000	99.875	99.750
	9.000	99.500	99.375	99.250	99.125
	7.750	98.125	98.000	97.875	97.750

15 YEAR FIXED - Program 101

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	9.125	103.375	103.250	103.125	103.000
	9.500	103.000	102.875	102.750	102.625
	9.375	102.500	102.375	102.250	102.125
25 BONUS $100,000 +	9.750	102.250	102.125	102.000	101.875
	9.625	102.000	101.875	101.750	101.625
	9.500	101.750	101.625	101.500	101.375
	9.375	101.500	101.375	101.250	101.125
	9.250	101.250	101.125	101.000	100.875
	9.125	100.750	100.625	100.500	100.375
	7.875	99.500	99.375	99.250	99.125
	7.750	99.250	99.125	99.000	98.875
	7.625	98.875	98.750	98.625	98.500
	7.500	98.375	98.250	98.125	98.000
	7.375	97.875	97.750	97.625	97.500
	7.250	97.500	97.375	97.250	97.125
	7.125	97.000	96.875	96.750	96.625
	7.000	96.375	96.250	96.125	96.000

30 YEAR FIXED JUMBO - Program 102

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Jumbo	9.250	100.000	100.375	100.250	100.000
	9.000	99.750	99.625	99.500	99.250
	8.750	99.125	99.000	98.875	98.625
	8.500	98.375	98.250	98.125	97.875

15 YEAR FIXED JUMBO - Program 103

	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Jumbo	8.750	100.250	100.125	100.000	99.750
	8.500	99.500	99.375	99.250	99.000
	8.250	98.875	98.750	98.625	98.375
	8.000	98.125	98.000	97.875	97.625

5-25 EXTENDABLE - Program 105

LTVs from 80.01% - 90.00%: Subtract .50 pts from conforming price

FHLMC	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	8.750	101.750	101.625	101.500	101.375
	8.500	101.250	101.125	101.000	100.875
	8.250	101.000	100.875	100.750	100.625
	8.000	100.750	100.625	100.500	100.375
	7.750	100.500	100.375	100.250	100.125
	7.500	99.750	99.625	99.500	99.375
	7.250	99.125	99.000	98.875	98.750
	7.000	98.500	98.375	98.250	98.125

7-23 EXTENDABLE - Program 107

FNMA	Rate	15 Day	30 Day	45 Day	60 Day
Conventional - Conforming	8.750	101.875	101.750	101.625	101.500
	8.625	101.625	101.500	101.375	101.250
	8.500	101.375	101.250	101.125	101.000
	8.375	101.250	101.125	101.000	100.875
	8.250	101.000	100.875	100.750	100.625
	8.125	100.625	100.500	100.375	100.250
	8.000	100.375	100.250	100.125	100.000
	7.875	100.125	100.000	99.875	99.750
	7.750	99.750	99.625	99.500	99.375
	7.625	99.500	99.375	99.250	99.125
	7.500	99.125	99.000	98.875	98.750
	7.375	98.750	98.625	98.500	98.375
	7.250	98.125	98.000	97.875	97.750

Don't forget! We now accept Investment Property!
Eligible for programs 100, 101 & 120 at stated price (-1.5 pts)!

--120 Day Extended Lock--		
Program 100	9.000	1/4 point fee funded at par
	9.250	1/4 point fee funded at 101.250
Program 101	9.125	1/4 point fee funded at par
	9.375	1/4 point fee funded at 101.250
Program 120	9.000	1/4 point fee funded at par
	9.250	1/4 point fee funded at 101.250
--180 Day Extended Lock--		
Program 100	9.125	1/4 point fee funded at par
	9.375	1/4 point fee funded at 101.250
Program 101	9.375	1/4 point fee funded at par
	9.625	1/4 point fee funded at 101.250
Program 120	9.250	1/4 point fee funded at par
	9.500	1/4 point fee funded at 101.250
--270 Day Extended Lock--		
Program 100	9.625	1/2 point fee funded at par
	10.125	1/2 point fee funded at 101.500
Program 101	9.875	1/2 point fee funded at par
	10.375	1/2 point fee funded at 101.500
Program 120	9.750	1/2 point fee funded at par
	10.250	1/2 point fee funded at 101.500

♦ All Extended Lock Fees Are Non-Refundable ♦

Rate Lock EXPIRATION Schedule

15 Day:	9/18/96	60 Day:	11/2/96	120 Day:	1/1/97
30 Day:	10/3/96	75 Day:	11/17/96	180 Day:	3/2/97
45 Day:	10/18/96	90 Day:	12/2/96	270 Day:	5/31/97

TEMPORARY BUYDOWN!

Now available for the following Programs:
100, 101, 105, 107, 120, 203, 204 & 225 !

Take corresponding conforming price and subtract percentage shown below!

2/1 Buydown (Program: 100, 105, 107, 203, 204, 225):-2.625 pts
2/1 Buydown (Program: 101):-3.5 pts
2/1 Buydown (Program: 120):-2.125 pts
1/0 Buydown (Program: 100, 101, 105, 107, 120, 203, 204, 225):-.875 pts

New Lock Terms for Programs 100,101,102,103,107&120!

15 Day: (60 Day Price -.125 pts)
♦30 Day: (60 Day Price -.250 pts) ♦Jumbos Included
♦120 Day: (60 Day Price -.625 pts)
♦120 Day: (60 Day Price -.750 pts) ♦Programs 102 & 103

CSR Phone Hotline: 800-542-5512
Fax Lines:
Rate Locks 800-426-5845
Conditions 313-741-5830
Closings 313-741-7997
Funding 800-432-1453

Rate Sheet No: 2282 - 1 Page 1 of 2
09:44 AM - TUESDAY, SEPTEMBER 3, 1996

Files received today are due out by the close of business on:
THURSDAY, SEPTEMBER 5, 1996

Our Underwriting Turnaround time is 48 hours!

NOTICE: Not for distribution to consumers. This information does not satisfy Truth-In-Lending advertising requirements. Rates and prices subject to change without notice. Minimum loan amount is $10,000. (Deduct 1.5 points in price for loans less than $25,000.)

BEST AVAILABLE COPY

ADJUSTABLE RATES

InterFirst

FHLMC - Program 200 1 Yr T

Non-Convertible-Conforming	Rate	15 Day	30 Day	45 Day	60 Day
Margin: 2.875	6.750	101.500	101.375	101.250	101.125
	6.500	101.125	101.000	100.875	100.750
	6.250	100.625	100.500	100.375	100.250
	6.000	100.125	100.000	99.875	99.750
	5.750	99.625	99.500	99.375	99.250
	5.500	99.125	99.000	98.875	98.750
	5.250	98.625	98.500	98.375	98.250
	5.000	98.125	98.000	97.875	97.750

JUMBO - Program 201 1 Yr T

Non-Convertible	Rate	15 Day	30 Day	45 Day	60 Day
Margin: 2.875	6.750	100.875	100.750	100.625	100.500
	6.500	100.375	100.250	100.125	100.000
	6.250	99.875	99.750	99.625	99.500
	6.000	99.375	99.250	99.125	99.000

FHLMC - Program 210 1 Yr T

Convertible-Conforming	Rate	15 Day	30 Day	45 Day	60 Day
Margin: 2.875	6.750	101.375	101.250	101.125	101.000
	6.500	100.875	100.750	100.625	100.500
	6.250	100.375	100.250	100.125	100.000
	6.000	99.875	99.750	99.625	99.500
	5.750	99.375	99.250	99.125	99.000
	5.500	98.875	98.750	98.625	98.500
	5.250	98.375	98.250	98.125	98.000

95% LTV on All ARMS!
(Mini Jumbo Programs to $300,000 Max)

NOW AVAILABLE! 75 & 90 Day Lock Terms on
All ARMS, MINI JUMBOS & 5 Yr Balloon!
75 Day: (60 Day Price -.25 pts) 90 Day: (60 Day Price -.50 pts)

Check out our LIBOR ARM!

Programs 200, 201, 203, 225, 210, 216:

- LTVs from 90.01% - 95.00%: Subtract .375 pts from product price, except Program 225: Subtract .500 pts!
- Second Bigger*!
  Subtract .25pts from conforming price!
  *(not allowed on Program 201)

FHLMC - Program 203 3/1 ARM

Non-Convertible-Conforming	Rate	15 Day	30 Day	45 Day	60 Day
Margin: 3.000	7.750	101.375	101.250	101.125	101.000
	7.500	100.875	100.750	100.625	100.500
	7.250	100.375	100.250	100.125	100.000
	7.000	99.875	99.750	99.625	99.500
	6.750	99.375	99.250	99.125	99.000
	6.500	98.875	98.750	98.625	98.500
	6.250	98.375	98.250	98.125	98.000

FHLMC - Program 225 5/1 ARM

Non-Convertible-Conforming	Rate	15 Day	30 Day	45 Day	60 Day
Margin: 3.000	8.250	101.375	101.250	101.125	101.000
	8.000	100.875	100.750	100.625	100.500
	7.750	100.375	100.250	100.125	100.000
	7.500	99.625	99.500	99.375	99.250
	7.250	98.875	98.750	98.625	98.500
	7.000	98.125	98.000	97.875	97.750

FHLMC LIBOR - Program 216 - Caps 1/6 - 6mo's

Non-Convertible-Conforming	Rate	15 Day	30 Day	45 Day	60 Day
Margin: 2.875	6.000	101.000	101.375	101.250	101.125
	5.750	101.125	101.000	100.875	100.750
	5.500	100.625	100.500	100.375	100.250
	5.250	100.125	100.000	99.875	99.750
	5.000	99.625	99.500	99.375	99.250

MINI JUMBO - Program 204 3/1 ARM
MINI JUMBO - Program 258 5/1 ARM

- Loan amounts from $207,001 - $350,000!
- Program 258: Maximum loan amount $500,000!
- Subtract .375 pts from corresponding conforming price to get Mini Jumbo price!
- LTVs from 90.01% - 95.00%: Subtract additional .375 pts from Mini Jumbo price, except Program 258: Subtract .500 pts!
- Subtract .250 pts for second homes!

Indexes: 1 Yr T 5.640 LIBOR 5.815

CSR Phone Hotline: 800-542-9512
Fax Lines:
Rate Locks 800-346-3643
Conditions 713-741-2630
Closings 713-741-2627
Funding 800-432-1455

Rate Sheet No: 2282 - 1 Page 3 of 2
09:44 AM - TUESDAY, SEPTEMBER 3, 1996

NOTICE: Not for distribution to consumers. This information does not satisfy Truth-In-Lending advertising requirements. Rates and prices subject to change without notice. Minimum loan amount is $10,000. (Deduct 1.5 points in price for loans less than $25,000.)

[Enlargement of Portion of Standard Federal Bank's September 3, 1996 Rate Sheet]

30 YEAR FIXED – Program 100

(25 year amortization available)

Conventional Conforming

.25 BONUS $100,000 + (Includes all Community Home Buyers programs)

Rate	15 Day	30 Day	45 Day	60 Day
9.500	103.500	103.375	103.250	103.125
9.375	102.875	102.750	102.625	102.500
9.250	102.625	102.500	102.375	102.250
9.125	102.375	102.250	102.125	102.000
9.000	102.000	101.875	101.750	101.625
8.875	101.375	101.250	101.125	101.000
8.750	101.125	101.000	100.875	100.750
8.625	100.875	100.750	100.625	100.500
8.500	100.500	100.375	100.250	100.125
8.375	99.750	99.625	99.500	99.375
8.250	99.375	99.250	99.125	99.000
8.125	99.000	98.875	98.750	98.625
8.000	98.375	98.250	98.125	98.000
7.875	97.625	97.500	97.375	97.250
7.750	97.125	97.000	96.875	96.750
7.625	96.500	96.375	96.250	96.125

APPENDIX Q

A.

SETTLEMENT STATEMENT
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

B. TYPE OF LOAN

1. FHA 2. FmHA 3. X Conv Unin
4. VA 5. Conv. Ins.
6. File Number 4569
7. Loan Number 6006118220
8. Mortgage Ins. Case No.

C. NOTE: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(poc)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals. WARNING: It is a crime to knowingly make false statements to the United States on this or any other similar form. Penalties upon conviction can include a fine and imprisonment. For details see: Title 18 U.S. Code Section 1001 and Section 1010.

D. NAME OF BORROWER: ADDRESS:	Lonnie Glove. and Dawn Christason-Glover
E. NAME OF SELLER: ADDRESS:	TAXPAYER ID NO.: TAXPAYER ID NO.:
F. NAME OF LENDER: ADDRESS:	Standard Federal Bank, A Federal Savings Bank
G. PROPERTY LOCATION:	817 3rd Street NE, Osseo, MN 55369
H. SETTLEMENT AGENT: ADDRESS:	Gibraltar Title Agency, LLC 7300 France Avenue South, Suite 100 Edina, MN 55435 (612) 830-1904 TIN: 41-1788872
I. SETTLEMENT DATE: September 19, 1996 DISBURSEMENT DATE: September 24, 1996	
PLACE OF SETTLEMENT: ADDRESS:	Gibraltar Title Agency 7300 France Avenue South, Suite 100, Edina, MN 55435

J. SUMMARY OF BORROWER'S TRANSACTION			K. SUMMARY OF SELLER'S TRANSACTION		
100. GROSS AMOUNT DUE FROM BORROWER:			400. GROSS AMOUNT DUE TO SELLER:		
101	Contract sales price		401	Contract sales price	
102	Personal property		402	Personal property	
103	Settlement chrge to borrower: (ln	4470.04	403	[illegible]	[illegible]
104	P/O to Capstead Mortgage	97037.38	404		
105	P/O to Bank One, Arizona	21456.40	405		
ADJUSTMENT FOR ITEMS PAID BY SELLER IN ADVANCE:			ADJUSTMENTS FOR ITEMS PAID BY SELLER IN ADVANCE:		
106	City/town taxes to		406	City/town taxes to	
107	County taxes to		407	County taxes to	
108	Assessments to		408	Assessments to	
109	Payoff delivery fees	40.00	409		
110			410		
111			411		
112			412		
120.	GROSS AMOUNT DUE FROM BORROWER:	123003.82	420.	GROSS AMOUNT DUE TO SELLER:	0.00
200. AMOUNTS PAID BY OR IN BEHALF OF BORROWER:			500. REDUCTIONS IN AMOUNT DUE TO SELLER:		
201	Deposit or earnest money		501	Excess deposit (see instructions)	
202	Principal amount of new loan(s)	124000.00	502	Settlement charges to seller (line	0.00
203	Existing loan(s) taken subject to		503	Existing loan(s) taken subject to	
204			504	Payoff of first mortgage loan	
205			505	Payoff of second mortgage loan	
206			506		
207			507		
208			508		
209			509		
ADJUSTMENTS FOR ITEMS UNPAID BY SELLER			ADJUSTMENTS FOR ITEMS UNPAID BY SELLER:		
210	City/town taxes to		510	City/town taxes to	
211	County taxes to		511	County taxes to	
212	Assessments to		512	Assessments to	
213			513		
214			514		
215			515		
216			516		
217			517		
218			518		
219			519		
220.	TOTAL PAID BY/FOR BORROWER:	124000.00	520.	TOTAL REDUCTIONS IN AMOUNT DUE SELL-	0.00
300. CASH AT SETTLEMENT FROM/TO BORROWER:			600. CASH AT SETTLEMENT TO/FROM SELLER:		
301	Gross amt due from borrower (line	123003.82	601	Gross amount due to seller (line	0.00
302	Less amounts paid by/for borrower (line 220)	124000.00	602	Less reductions in amount due seller (line 520)	0.00
303	CASH ... FROM .X. TO BORROWER:	(996.18)	603	CASH ___ TO ___ FROM SELLER:	0.00

L. SETTLEMENT CHARGES		PAID FROM BORROWER'S FUNDS AT SETTLEMENT	PAID FROM SELLER'S FUNDS AT SETTLEMENT
700.	TOTAL SALES/BROKER'S COMMISSION based on price $ at % = $ Division of commission (line 700) as follows:		
701.	$ to		
702.	$ to		
703.	Commission paid at Settlement (Money retained by broker applied to commission $)		
704.			
800.	*ITEMS PAYABLE IN CONNECTION WITH LOAN:*	1240.00	
801.	Loan Origination fee 1% to Heartland Mortgage		
802.	Loan Discount %		
803.	Appraisal Fee to: Heartland Mortgage ($295.00 POC)		
804.	Credit Report to: Heartland Mortgage ($50.00 POC)	200.00	
805.	Underwriting fee to Standard Federal Bank	10.00	
806.	Flood certification to Standard Federal Bank	150.00	
807.	Document preperation to Standard Federal Bank	335.00	
808.	Processing fee to Heartland Mortgage	32.00	
809.	Express Mail Fee to Heartland Mortgage	40.00	
810.	Funding Fee to Standard Federal Bank		
811.	Service release premium to Heartland Mortgage paid by SFB (1.25% = $1650.00 POC)		
900.	*ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE:*		
901.	Interest from 09/24/96 to 10/01/96 at $30.14 per day	210.98	
902.	Mortgage Insurance Premium for mos. to		
903.	Hazard Insurance Premium for yrs. to		
904.			
905.	2nd half of 1996 property taxes have been paid by Capstead on 9/18/96 $1350.90		
1000.	*RESERVES DEPOSITED WITH LENDER:*		
1001.	Hazard Insurance 12 months at $38.42 per month	461.04	
1002.	Mortgage Insurance months at $ per month		
1003.	City property taxes months at $ per month		
1004.	County property taxes 2 months at $225.16 per month	450.32	
1005.	Annual assessments months at $ per month		
1006.	months at $ per month		
1007.	months at $ per month		
1008.	Aggregate Analysis Adjustment		
1100.	*TITLE CHARGES*		
1101.	Settlement or closing fee to Gibraltar Title	250.00	
1102.	Abstract or title search to Gibraltar Title	150.00	
1103.	Title examination to		
1104.	Title insurance binder to		
1105.	Document preparation to		
1106.	Notary fees to		
1107.	Attorney's fee to		
	(includes above items numbers;	482.00	
1108.	Title insurance to Gibraltar Title		
	(includes above items numbers;		
1109.	Lender's coverage $124,000.00		
1110.	Owner's coverage $		
1111.			
1112.			
1113.			
1200.	*GOVERNMENT RECORDING AND TRANSFER CHARGES:*		
1201.	Recording fees: Deed $; Mortgage $19.50; Releases $39.00	58.50	
1202.	City/County tax/stamps: Deed $; Mortgage $		
1203.	State tax/stamps: Deed $; Mortgage $285.20	285.20	
1204.	Conservation fee	5.00	
1205.	Recording service fee to Gibraltar Title	30.00	
1300.	*ADDITIONAL SETTLEMENT CHARGES:*		
1301.	Survey to		
1302.	Pest inspection to	50.00	
1303.	Plat drawing to Gibraltar Title	30.00	
1304.	Assessment search to Gibraltar Title		
1305.			
1306.			
1307.			
1400.	*TOTAL SETTLEMENT CHARGES (enter on lines 103, Section J and 502, Section K)*	4470.04	0.00

I have carefully reviewed the HUD-1 Settlement Statement and to the best of my knowledge and belief, it is a true and accurate statement of all receipts and disbursements made on my account in this transaction. I further certify that I have received a copy of the HUD-1 Settlement Statement.

Borrower: _____ Seller: _____

_____

To the best of knowledge, the HUD-1 Settlement Statement which I have prepared is a true and accurate account of the funds which were received and have been or will be disbursed by the undersigned as part of the settlement of this transaction.

SETTLEMENT AGENT: _____ DATE: 9/9/96

APPENDIX R

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)

LONNIE GLOVER, DAWN GLOVER, AND ALL OTHERS SIMILARLY SITUATED,
Plaintiffs,

v.

STANDARD FEDERAL BANK AND HEARTLAND MORTGAGE,
Defendants.

[May 19, 1998]

DEPOSITION OF STEVEN C. KAPP

* * * * *

[3]

* * * * *

Q. Can you please state your full name for the record?

A. Steven C. Kapp.

Q. Mr. Kapp, by whom are you employed?

A. Standard Federal Bank?

* * * * *

[19]

* * * * *

Q. In your position do you have any contact with individual mortgage brokers or mortgage broker companies?

A. No.

Q. Are the particular services that a mortgage broker performs in any given transaction a factor that go into the pricing on Exhibit 1 [rate sheet]?

A. No, I am not aware of any services.

* * * * *

[26]

* * * * *

Q. Looking at Exhibit 1 again. Over to the left-hand side, the 30-year fixed, Program 100 column and then some of the other charts or matrixes underneath that discussing the prices, right here it says .25 bonus, $100,000 plus. What does that mean?

A. We will add .25 percent to the price if the loan amount is greater than 100,000.

Q. When you say .25 percent is added to the price, that's additional money that goes to the broker?

A. Correct.

Q. So if you have a loan with a principal value of $99,000 and a loan with a principal of $101,000, and all other – and all other things are the same, the rate, the term, the program and the date, the time they walked in, everything else is the same, the only difference is that the principal value on the $99,000 loan the broker [27] receives the price on the chart here, on the matrix part of the chart, these columns; and on the loan with the principal value of a hundred and one the broker would receive the same price on the chart plus an additional bonus of .25 percent?

A. Correct.

Q. And can you explain why that is paid?

A. The cash flow stream on the $101,000 loan is greater than the $99,000 loan

Q. And that's not paid, so that's not paid based on anything specific, as far as InterFirst notes, that the broker did differently, it's just factored on the principal value?

A. Correct.

Q. That's not tied to any particular service or anything that the broker did?

A. No, not that I am aware.

* * * * *

APPENDIX S

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)

LONNIE GLOVER, DAWN GLOVER, AND ALL OTHERS SIMILARLY SITUATED,
Plaintiffs,

v.

STANDARD FEDERAL BANK AND HEARTLAND MORTGAGE,
Defendants.

[March 11, 1998]

DEPOSITION OF DAVID PRICHARD

* * * * *

[3]

* * * * *

Q. Can you please state your name for the record?

A. Dave Prichard.

Q. And Mr. Prichard, where are you employed?

A. Standard Federal Bank.

Q. And that's here in Ann Arbor?

A. Yes, sir.

Q. And what is your position?

A. Currently assistant operations manager.

* * * * *

[55]

Q. Is not the only factor that affects the amount of money a broker is going to get as a yield spread premium the rate at which he brings the loan to Standard Federal to fund that?

A. No.

Q. What else does the broker do to affect the amount of premium he's going to get?

A. The pricing model doesn't have anything to do with what the broker does or doesn't do.

Q. Mr. Stoller testified that the only variable that determines the yield spread premium he gets or his company gets from this chart is the interest rate. Do you disagree with that?

A. I have no direct knowledge of what Mr. Stoller thinks.

Q. I'm just asking you if you agree or disagree with his statement. The testimony was, "The only variable that determines the yield spread from the chart is the interest rate?" "That's correct, yes." Page 14.

A. Given that that's the only variable in the pricing model that's actually displayed on the [56] rate sheet, I think that that's a reasonable conclusion on his part.

Q. Are there other variables that the broker has some control over in determining the amount of yield spread the broker company is going to get?

A. No.

* * * * *

APPENDIX T

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)

LONNIE GLOVER, DAWN GLOVER, AND ALL OTHERS SIMILARLY SITUATED,
Plaintiffs,

v.

STANDARD FEDERAL BANK AND HEARTLAND MORTGAGE,
Defendants.

[May 23, 2001]

DEPOSITION OF JEFFREY CONNER

* * * * *

[7]

* * * * *

Q. Would you state your full name for the record, please?

A. Jeffrey Lynne Conner.

* * * * *

Q. And by whom are you employed?

A. ABN-AMRO North America.

* * * * *

[14]

* * * * *

Q. * * * What is your title with AMRO North America?

A. I don't hold a title there.

Q. What is your job title?

A. I function as a manager for ABN-AMRO North America.

* * * * *

Q. * * * What are you manager of?

A. I manage a number of functions in their Midwest Retail Operations.

* * * * *

[211]

* * * * *

Q. * * * You fund loans in Texas on one day and on the same day you fund loans in Minnesota, and you're willing to pay the Texas broker an extra amount of money so that he will send you that business rather than sending it to your competitor but you do not pay the Minnesota broker a similar incentive. Are you aware of that?

* * * * *

A. If it was that simple, that all we had to do is offer an incentive and the broker would automatically send us his business instead of sending it to a competitor, we could have all of the business in the world and we don't. We have a very small market share. So you're making the implication that we have incentive pricing and that somehow guarantees –

Q. No. I didn't ask that.

A. – that we will get that loan.

Q. No, I never said one word about guarantee. I said the purpose.

A. You said to get the loan from that broker instead of them sending it to the competitor. That's exactly what you [212] said.

Q. I said the purpose of offering the payment is to induce, to try to get him to send it to you instead of to your competitor.

A. The purpose of offering any payment is to induce them to sell it to us. We have to be competitive in the market place. We may offer incentives from time to time, that in no way guarantees we are going to keep this business away from our competitors. It's just a pricing.

Q. Of course. A competitor might offer the broker more money?

A. That's right.

Q. And if so the broker might refer the loan to that competitor and not to you?

A. That's right.

Q. So it's a tough market, where you're offering money to the brokers to try and induce them to send them to you, the competitors are offering money to get them to send it to them, right?

A. Yeah, but I don't understand your geographic.

Q. I'll come back to the geography. Just answer the one question.

A. What I'm saying is we price to get business. And we price what we feel is a market price.

Q. To beat out –

[213]

A. Well, we don't always beat out the competition. We don't have the lowest price.

* * * * *

APPENDIX U

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

Civil No. 97-2068 (DWF/AJB)

LONNIE GLOVER, DAWN GLOVER, AND ALL OTHERS SIMILARLY SITUATED,
Plaintiffs,

v.

STANDARD FEDERAL BANK AND HEARTLAND MORTGAGE,
Defendants.

[March 14, 2001]

DEPOSITION OF WILLIAM NEWMAN

* * * * *

[7]

* * * * *

Q. What is your job title and with whom?

A. My job title is president of the InterFirst division of the ABN AMRO Mortgage Group.

* * * * *

[140]

* * * * *

Q. Okay. And how do you know, the bank – that is, how does Standard Federal in its day and how does AMRO today know that the broker is due to have anything paid?

A. We don't feel it's our responsibility to understand fully what the broker needs to be compensated on a transaction. We feel that's a transaction between the broker and the consumer.

Q. Well, but you have to – if it's a payment to the broker, it's presumably because the money is due to the broker, right?

A. It's a part of the funding transaction, yes –

Q. Okay.

A. – that's due to the broker.

Q. Well, do you contend on behalf of AMRO or did you on behalf of Standard Federal when you were swearing in the Stachowski case, that the yield spread premium is used to reduce closing costs to borrowers?

* * * * *

A. It may or may not be. I'm not familiar with the individual.

[141]

* * * * *

Q. How about, is that what you think it's used for? Is that your purpose in it?

A. It can be used for whatever the broker and the consumer decide it needs to be used for.

Q. I see. So it's – from the point of view of ABN AMRO or Standard Federal, you're not using it, you are not using it and did not when it was Standard Federal use it, for the purpose of reducing closing costs to borrowers * * *?

A. Again, it's not our specific intent to use it to reduce closing costs. It's between the broker and the consumer.

Q. Okay. Have you done any studies at all to see whether that's what it's being used for?

A. Not specifically that I can think of, no.

* * * * *

[168]

* * * * *

Q. Okay. That's what you were doing when you offered that Texas incentive, isn't it?

A. There was a couple things that we were doing. One, we were – we were not able in our model to recognize that the value of loans from Texas was greater; therefore, we inserted it into the price component as opposed to the value component of our model.

Q. Well, you weren't getting enough loans from Texas, right?

A. Again, that's a judgment. No, we weren't, not [169] in my judgment, no.

Q. Okay. And you wanted more?

A. Sure.

Q. So you offered more money?

A. Yes.

Q. Okay. And the brokers sent you more?

A. Well, not as much as we would have liked, no.

Q. But – but they sent you some more? Okay. And if you had offered, maybe – Is your answer yes?

A. Oh, yes, yes.

Q. And in fact, loans above $100,000 are – are more valuable to you, aren't they?

A. The secondary market dictates, yeah, that they are.

Q. Okay, which means you can sell them for more money in the secondary market?

A. There's a value recognition, yes. From time to time, it may not be the exact amount that we pay, but . . .

Q. But in general, that asset is more valuable because you can sell it for more money –

* * * * *

A. Yes.

[170]

Q. (BY MR. GILL): And so you offer an additional incentive to get those loans, right?

A. We offer additional pricing, yeah, sure.

Q. Well, pricing is an offer of more money, and the purpose of it is to get those hundred thousand plus – $100,000 plus loans, right?

A. Well, it's to recognize the value in the marketplace, yes, which could result in you being competitive, certainly.

Q. Sure. And if you're not competitive, the broker will send it to somebody who is, right?

A. Yes.

* * * * *

Pam Daine
Account Executive

InterFirst A Division of
Standard Federal Bank
Savings/Financial Services

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IT'S TIME TO CHANGE OUR PRICING

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REGIONAL PRICING FOR TEXAS PROPERTIES!

Effective 07/23/01, **INTERFIRST WHOLESALE LENDING** will now pay .375 (instead of .50 pt) on all conforming fixed (and extendable) TEXAS properties for our WHOLESALE customers. Our **PURCHASE PRICE SPECIAL** IS NOW .25 (instead of .375) . THIS IS IN ADDITION to our other pricing incentives:

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Base rate sheet price =		100.00
TX Properties(Conforming fixed rates, A- & extendable only)	+	.375
Conforming over $100,000(fixed , A- and gov't)	+	.25
All **purchase** loans special (jumbo & conforming)	+	.25
Your company key acct. price(jumbo & conforming)	+	.25
Total pricing incentives:		101.125

That's right! You make ($1,125.00) 1.125 points over the rate sheet price! That's more money in YOUR pocket!

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